#sukuk2022

## Sukuk perceptions and forecast study 2022

# NAVIGATING A NEW ENVIRONMENT

An LSEG Business

REFINITIV®

# Contents

# Foreword

The past couple of years have presented unprecedented market conditions for global sukuk, with the market having to navigate both the covid-19 pandemic and the huge economic challenges that followed.

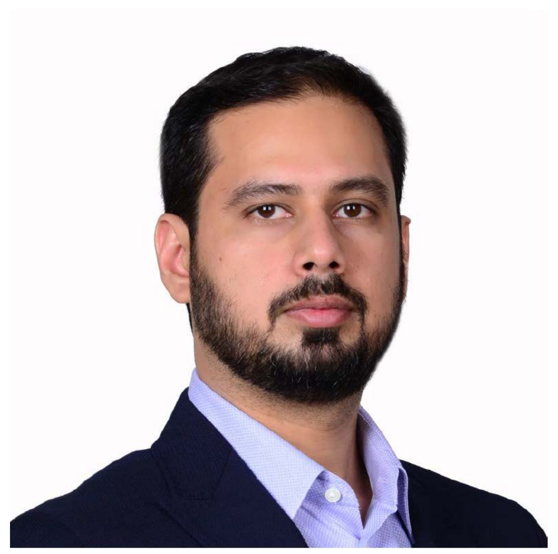
The pandemic proved a boon for sukuk markets. Issuance was at record-breaking levels in 2020 and 2021 as governments tapped debt markets to fund Covid-recovery programmes, encouraged by still-low borrowing costs. But as 2022 got underway and economies began to show signs of recovery, new global risks emerged that would introduce a new economic environment for the sukuk market to deal with.

As a result of the Ukraine conflict, oil prices have traded largely above $100/bbl and inflation has soared, resulting in multiple interest rate hikes after 15 years at near-zero levels. According to the IMF, the world is facing a significant risk of recession this year that will likely worsen in 2023. This is uncharted territory for a mature sukuk market. It is shifting market dynamics and leaving the near-term outlook uncertain, with differing views on the market's likely direction.

Refinitiv's annual "Sukuk Perceptions and Forecast Study" is the most comprehensive reference on the global sukuk market, offering industry stakeholders current and forward-looking views on evolving market developments. This in-depth report provides an overview of the primary and secondary sukuk markets, highlighting the impact of recent geopolitical and economic developments on the supply and demand for sukuk as well as price performance in domestic and international markets.

Our proprietary sukuk supply and demand model translates the divergent outlook for sukuk into projections for issuance, market size and the supply-demand gap, based on forward-looking analysis of the impact of recent developments on future market variables.

The report also features the findings of Refinitiv's 2022 sukuk survey, which shed light on market perceptions of future growth, trends and the continuing challenges facing both sukuk issuers and investors.



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**Redha Al Ansari**

*Head of Islamic Finance Research*

# Executive summary

## Sukuk issuance moderates in first half of 2022

Global sukuk issuance in the first half of 2022 raised $100.9 billion, marginally lower than $104.2 billion H1 2021. Despite a strong start to the year, issuance momentum slowed as the Federal Reserve and other central banks kicked off a global monetary tightening cycle. The surge in oil prices also contributed to the slowdown in issuance, as it reduced government borrowing needs in core sukuk markets.

A new sukuk issuance record had been set in 2021 for the fifth consecutive year, reaching a total of $196.5 billion. Although this was a rise of 8.2% from $181.6 billion in 2020, that compares with much greater average annual growth of 21% in the previous five years.

## Saudi issuance rises amid economic pressures

Malaysia, Saudi Arabia and Indonesia remained the largest issuance bases for sukuk and together made up nearly 75% of sukuk issued in 2021 through to H1 2022.

Malaysia maintained its leading position, although issuance of $34.8 billion in H1 2022 was down 14% from H1 2021 as rising commodity prices drove a post-Covid economic recovery. However, with inflation now posing a threat to that recovery, government subsidies and cash assistance to mitigate its effects will increase pressure on government spending and ensure the sovereigns will remain active in capital markets.

In Saudi Arabia, sukuk issuance raised $28.1 billion during H1 2022, compared with $24.2 billion during the same period of 2021, despite the surge in oil prices. Still, issuance slowed during the second quarter as the Kingdom registered a surplus from higher oil revenues. As with most GCC governments, issuances supporting new and continuing infrastructure projects will likely be offered once volatility in global financial markets calms. This is also the case with ESG issuances that are in the pipeline awaiting more conducive conditions.

## Corporate issuance slows under rates pressure, sovereigns still dominate

Sovereigns continue to drive sukuk issuance, maintaining around a 60% share of global issuance since 2017. Sovereign sukuk issued in H1 2022 totalled $68.8 billion, of which 83% were issued by GCC, Malaysian and Indonesian governments. The Saudi government was the largest sovereign issuer in H1 2022, with $22.1 billion, despite soaring oil prices having reduced government funding requirements.

Corporate issuance amounted to $19.7 billion in the first half of 2022, down 7.8% from a year prior due to rapidly increasing interest rates. Issuance from corporates is likely to moderate by the end of the year, with expectations of as many as seven Fed rate hikes across the year. Yet, as economic activity resumes, the anticipation of further policy rate hikes may nudge corporate issuers to bring forward debt issuance in order to lock in current lower rates, led by the financial services, infrastructure and utilities industries.

## Higher rates hinder issuers' attraction to international sukuk markets

The momentum of international sukuk issuance slowed in 2022, despite strong activity from issuers capitalising on high demand from international investors early in the year. Dollar sukuk issuance amounted to $22 billion in H1 2022, down 10% from $33.2 billion in H1 2021, as issuers concentrated their borrowing in domestic markets and the Federal Reserve's tightening policy strengthened the dollar. While corporate dollar sukuk increased, sovereigns relied on borrowing from domestic markets in the first half of 2022.

Federal Reserve economists project further increases will lift the benchmark rate to a range of 3.25% to 3.5% by the end of the year, which will likely deter some issuers from international markets.

However, as the aggressive monetary tightening policy pushed up the dollar, emerging debt markets saw huge sell-offs and outflows of foreign investment. Return differentials between debt, including sukuk, in developed versus emerging markets led international or foreign investors to return to developed debt markets. While some of these investors will return to the sukuk market seeking high yields, demand will be driven mainly by investors in the domestic market.

## Sukuk secondary market resilient as emerging market debt markets slide

The global sukuk secondary market grew during H1 2022. The value of sukuk outstanding reached $726.8 billion, up 4.4% from the end of 2021. The secondary sukuk market is highly concentrated within the three largest jurisdictions – Malaysia, Saudi Arabia and Indonesia – which together made up 80% of the value of sukuk outstanding in H1 2022.

Sukuk markets fared better than emerging market bonds, with the former supported by a boom in oil prices and most issuers' limited exposure to the Ukraine conflict. The FTSE Emerging Markets Broad Bond Index in 2022 had its worst start to a year in 25 years, as emerging market debt underperformed most fixed income markets, fuelled by multiple rate hikes, inflationary pressures and geopolitical developments.

## Stable outlook for sukuk supply despite global headwinds

Following a five-year record streak, global sukuk issuance is set to moderate in 2022. The Refinitiv sukuk supply and demand model projects sukuk issuance to settle at $185 billion by the end of the year. Sukuk supply, as defined by total sukuk outstanding, reached $726.8 billion in H1 2022 and is projected to increase to $742.3 billion by the end of the year.

In the 2022 Refinitiv sukuk survey, 41% of respondents indicated they were still bullish about growth in global sukuk supply, expecting issuance to reach $180 billion or more in 2022.

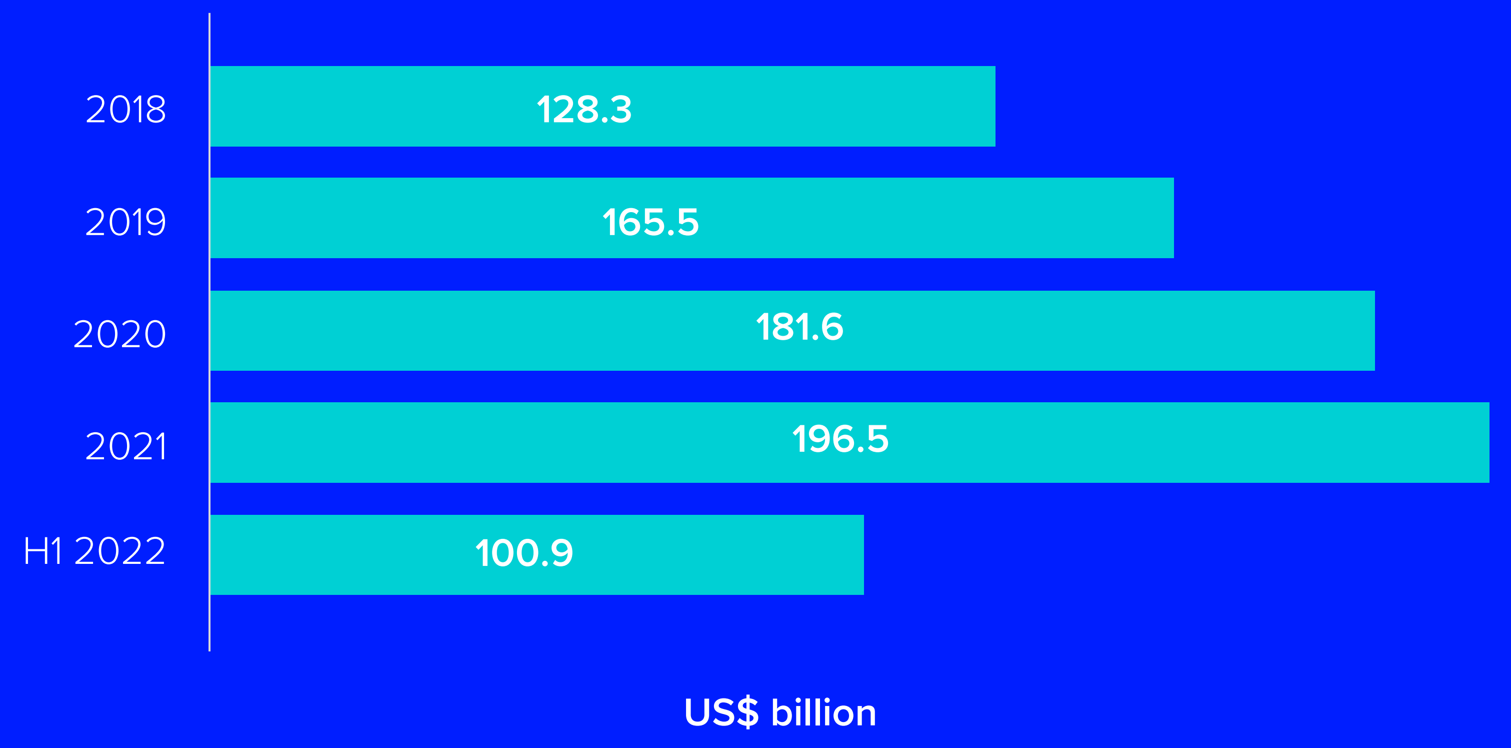
Continued robust demand for sukuk and increasing budgetary pressures on emerging economies such as Malaysia, Indonesia and Pakistan have buoyed global issuance so far in 2022, reducing the likelihood of a significant drop in issuance over the full year.

Looking further ahead, issuance is projected to grow at an estimated compounded annual growth rate of 6.8% over the next five years, reaching $257 billion in 2027. The size of the sukuk market is expected to reach $1.1 trillion in that year, growing at a compounded annual growth rate of 7.9%.

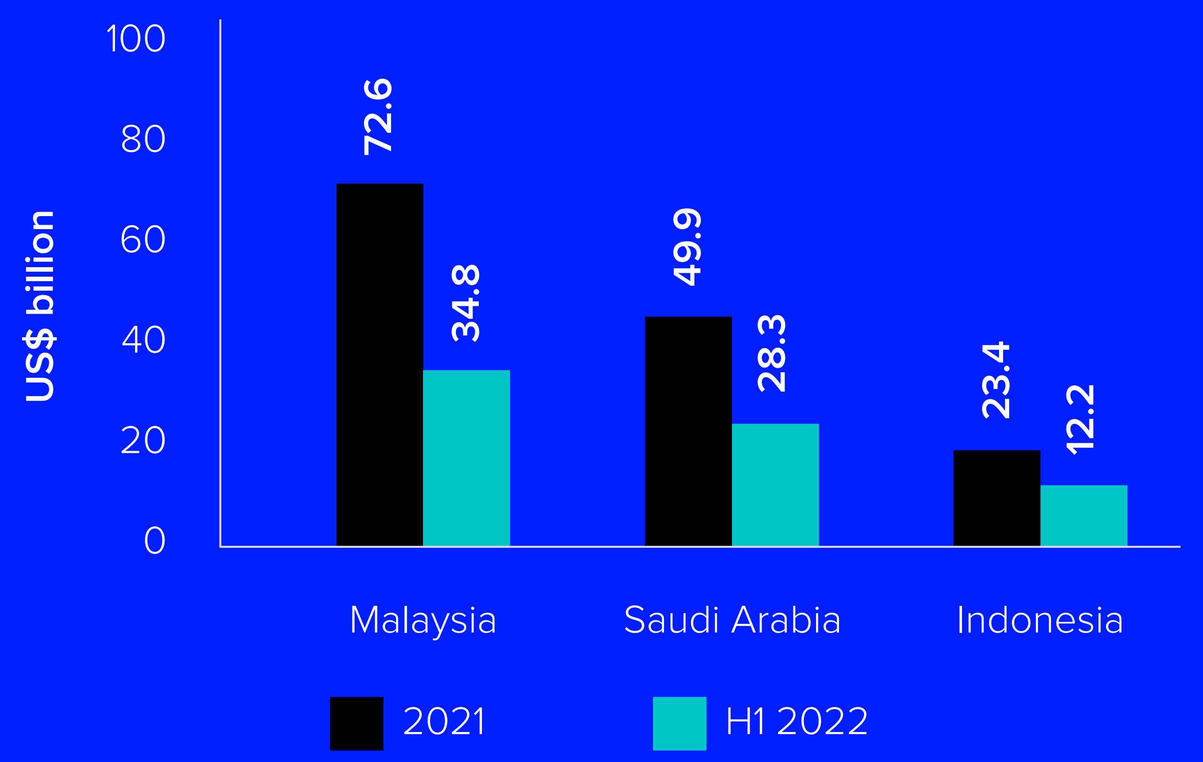
The model thus projects the supply-demand gap to narrow to $81.4 billion in 2022 and $69.1 billion in 2023. The gap is projected to then expand to $101.4 billion by 2027, as 52% of presently outstanding sukuk mature by the end of 2027, causing a considerable reduction in sukuk supply compared to the past five years.

# Global sukuk landscape

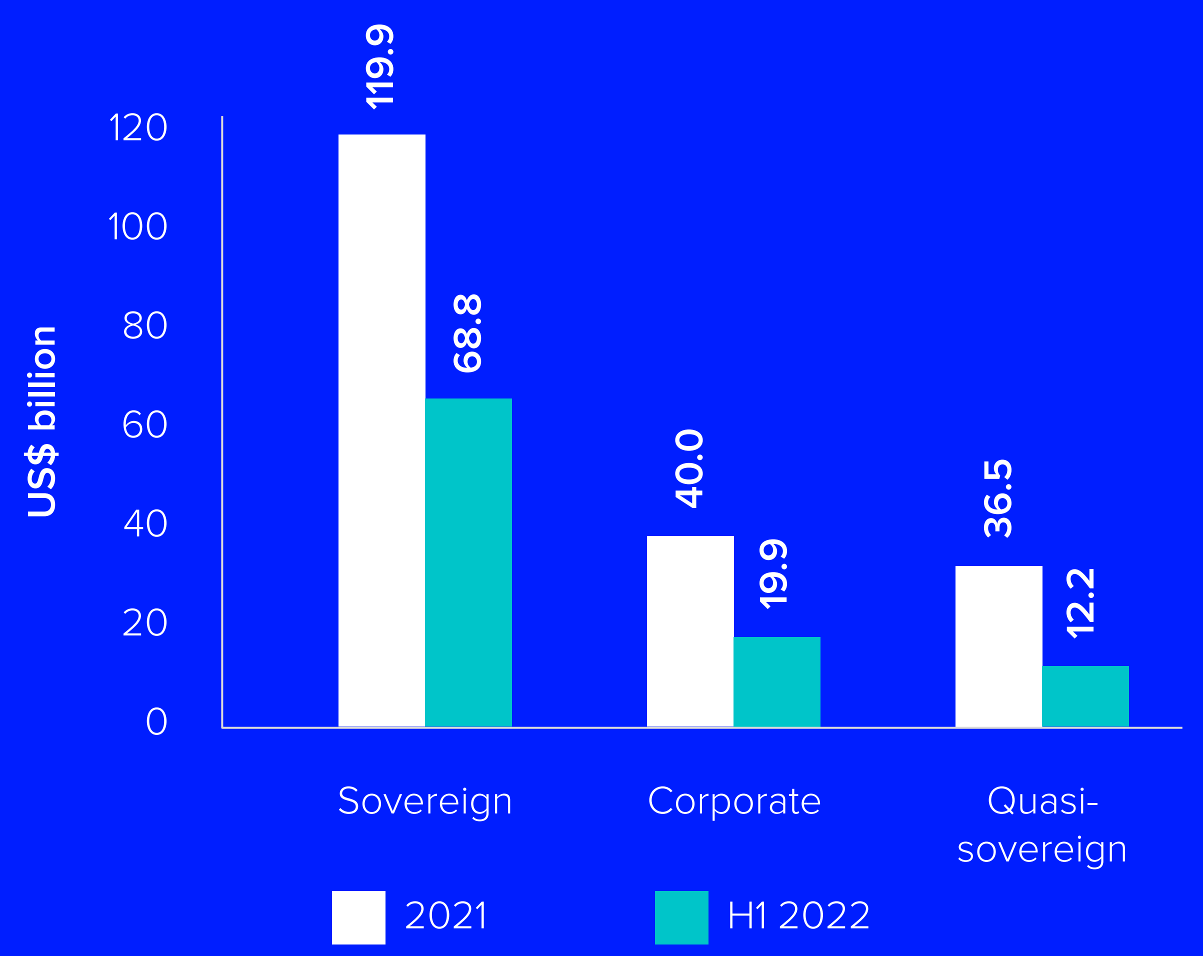
### Historical sukuk issuance 2018 to H1 2022



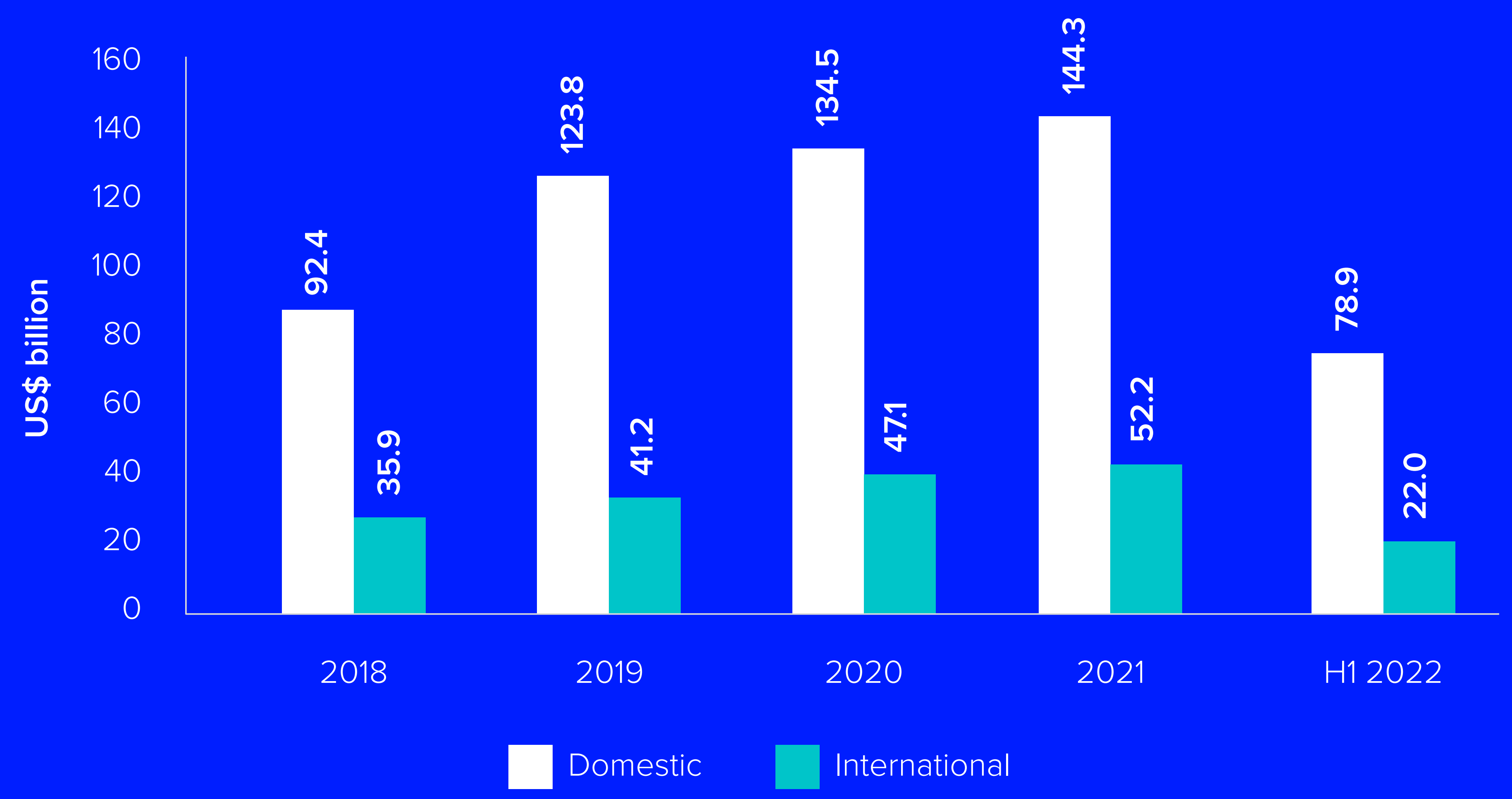

### Top three countries by sukuk issuance 2021 to H1 2022




### Sukuk issuance by issuer type 2021 to H1 2022




### Sukuk issuance by market 2021 to H1 2022



# Global sukuk outlook

### Impact of recent developments on sukuk supply and demand

**GEOPOLITICAL TENSIONS**

Muted impact

**HIGH OIL PRICES COMMODITY PRICE SHOCKS**

- ▼ Gulf Cooperation Council (GCC) sovereign funding needs
- ▼ Pace of economic recovery in other markets

**MONETARY TIGHTENING POLICIES**

- ▲ Spending on inflation mitigation
- ▲ Yields
- ▲ Profit/coupon payments
- ▲ Reinvestment and price risks

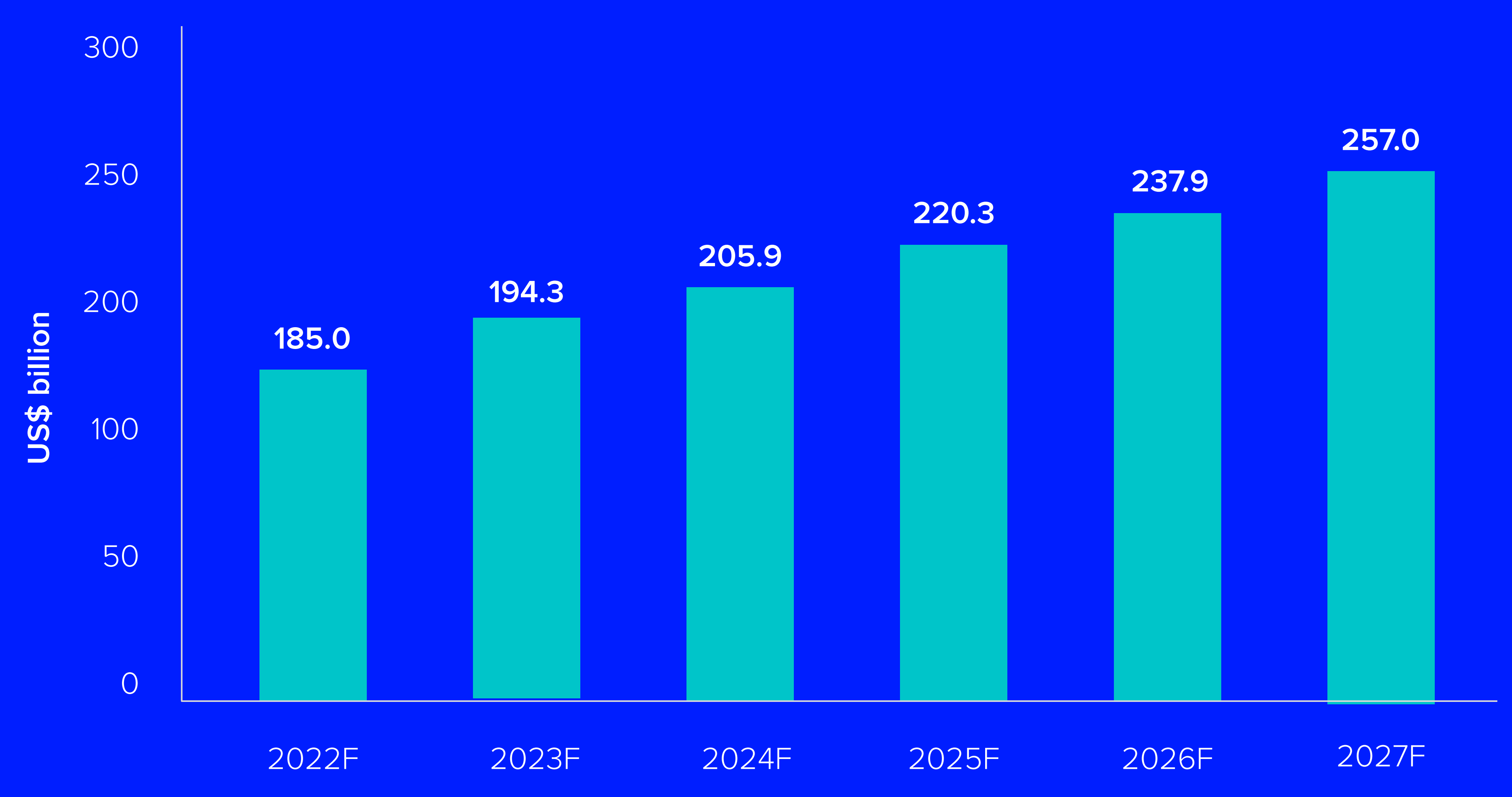
**SUKUK SUPPLY**

- ▼ GCC sovereign issuance
- ▲ Other sovereign issuance
- ▼ Corporate issuance
- ▲ Long-term issuance
- ▲ Domestic issuance

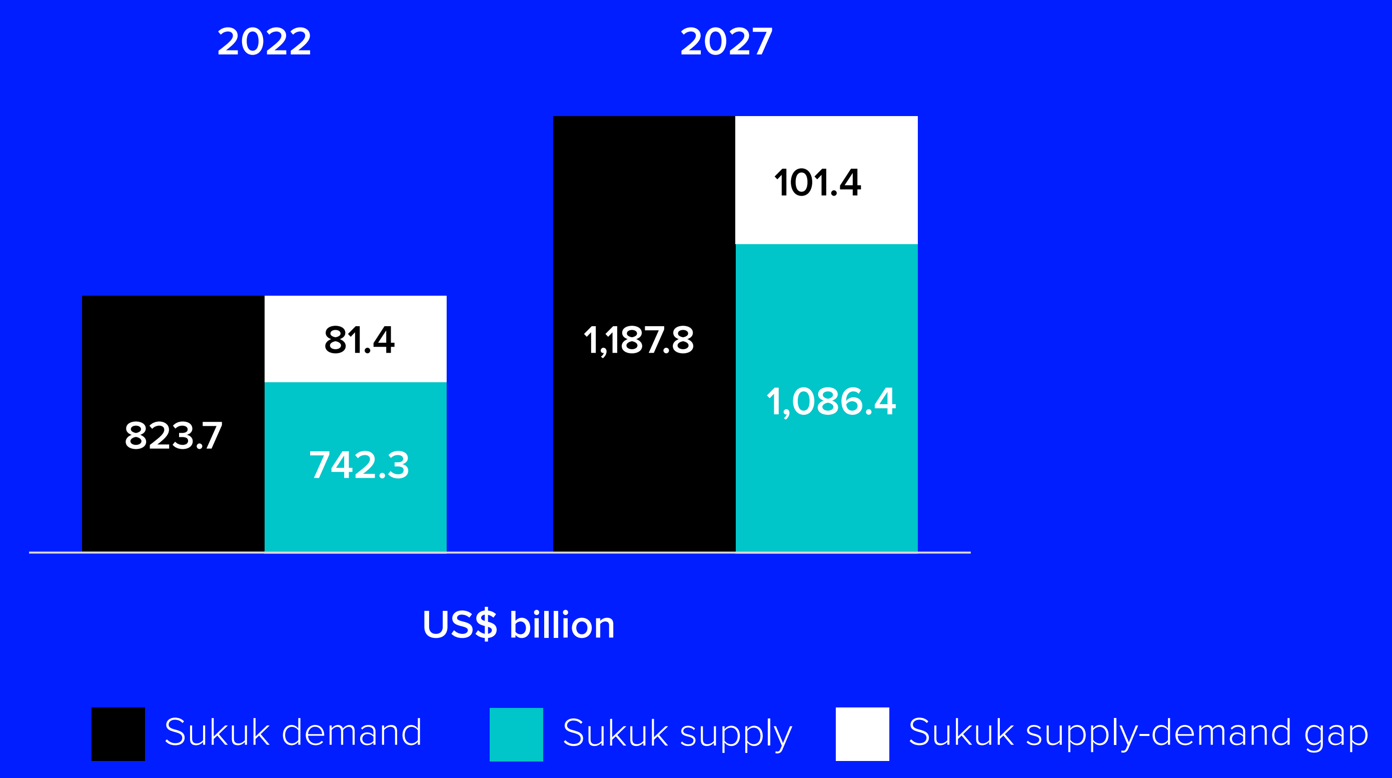
**SUKUK DEMAND**

- ▼ Demand from non-Shariah-sensitive investors
- ▲ Demand from Shariah-sensitive investors
- ▲ Demand for short-term sukuk
- ▲ Demand for domestic sukuk

### Sukuk issuance projections 2022 to 2027

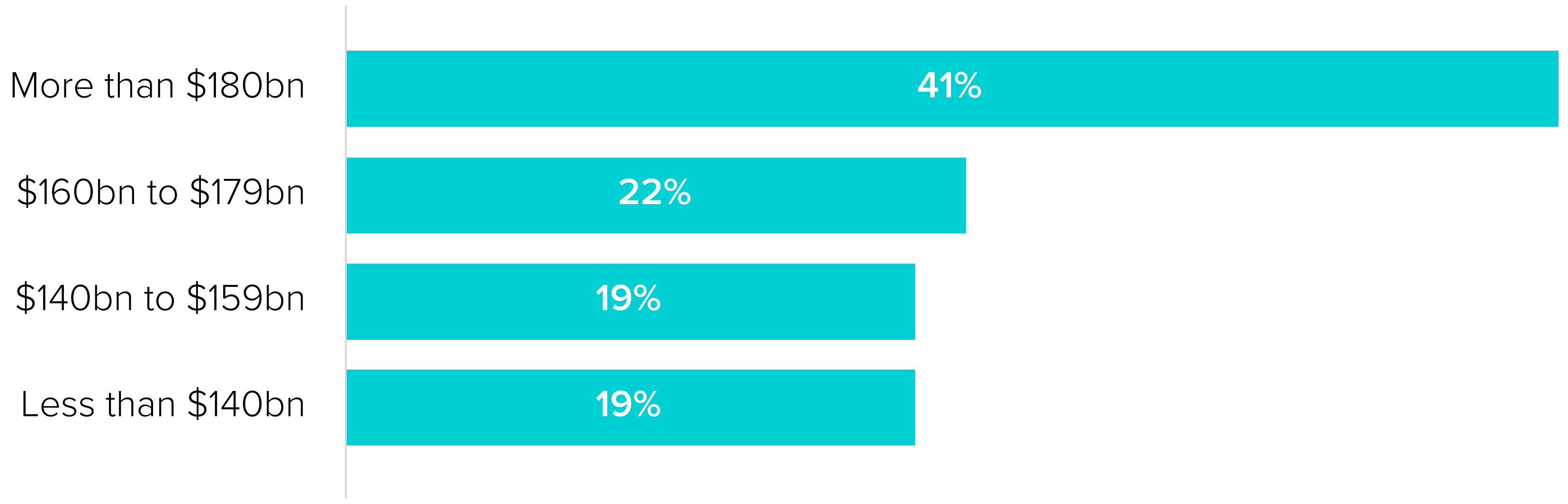



### Supply and demand projections 2022 and 2027



# Refinitiv sukuk survey insights

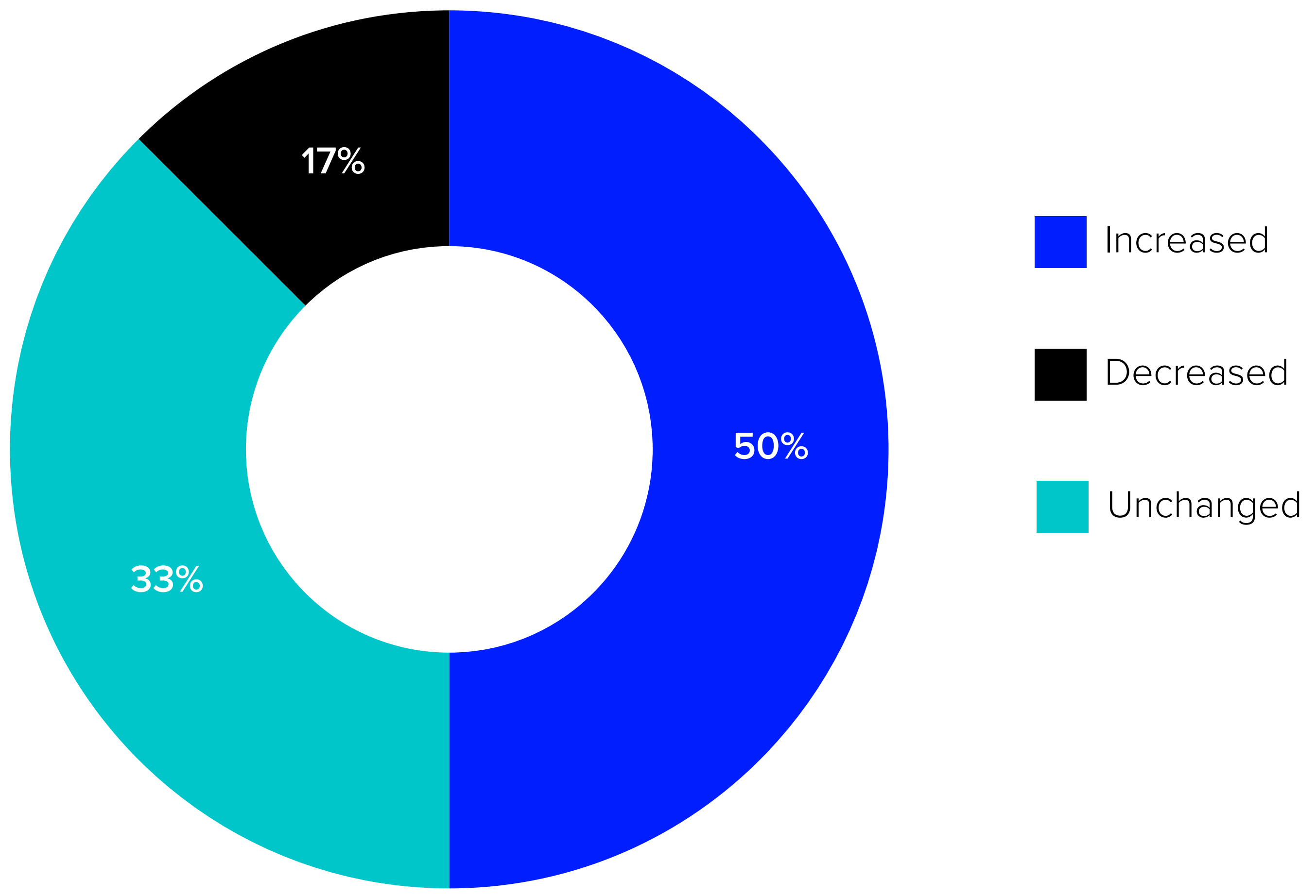
### Expected sukuk issuance in 2022



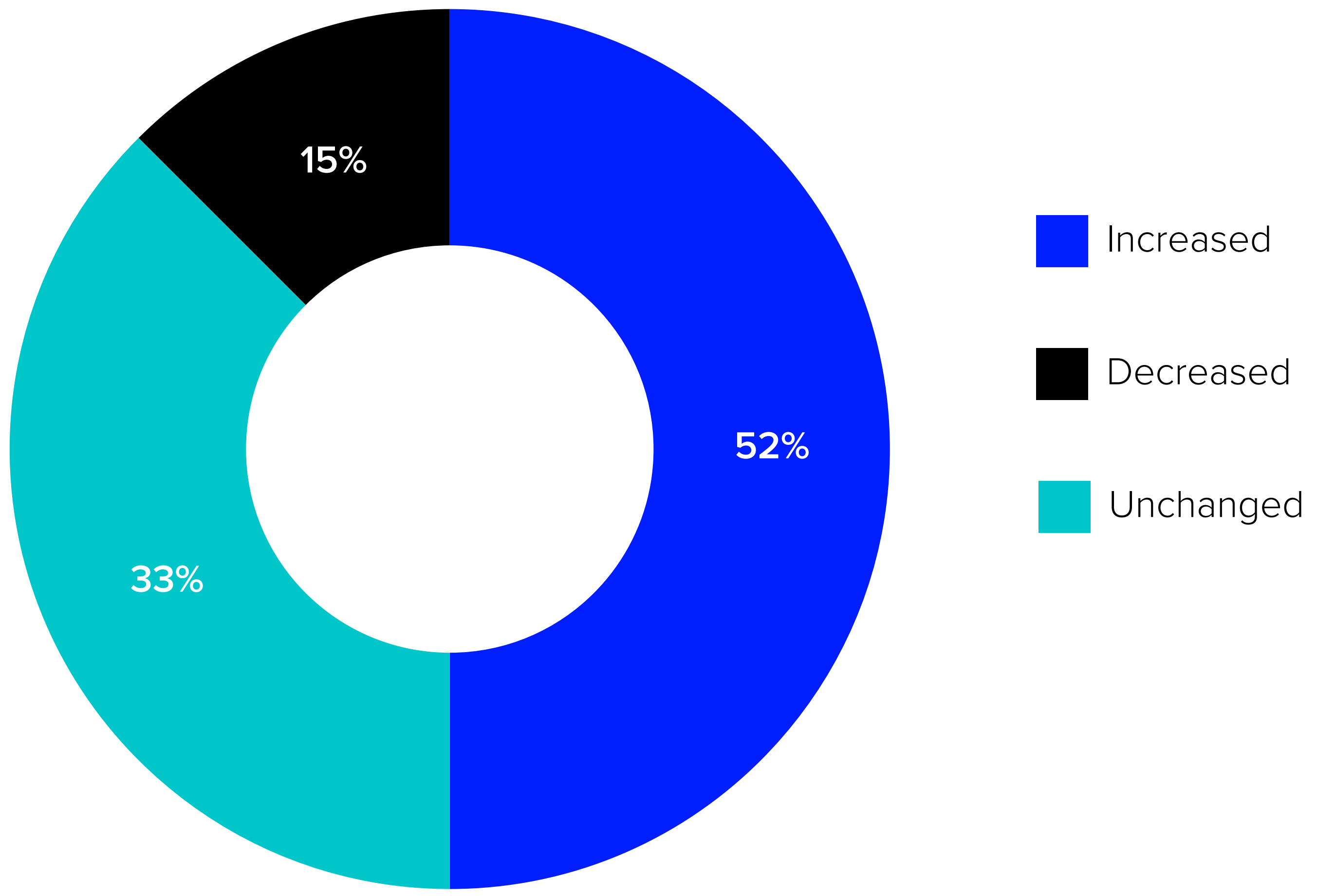

### Top three reasons to issue sukuk

- Stronger demand for sukuk compared to bonds
- Diversify sources of funding
- Wider investor base

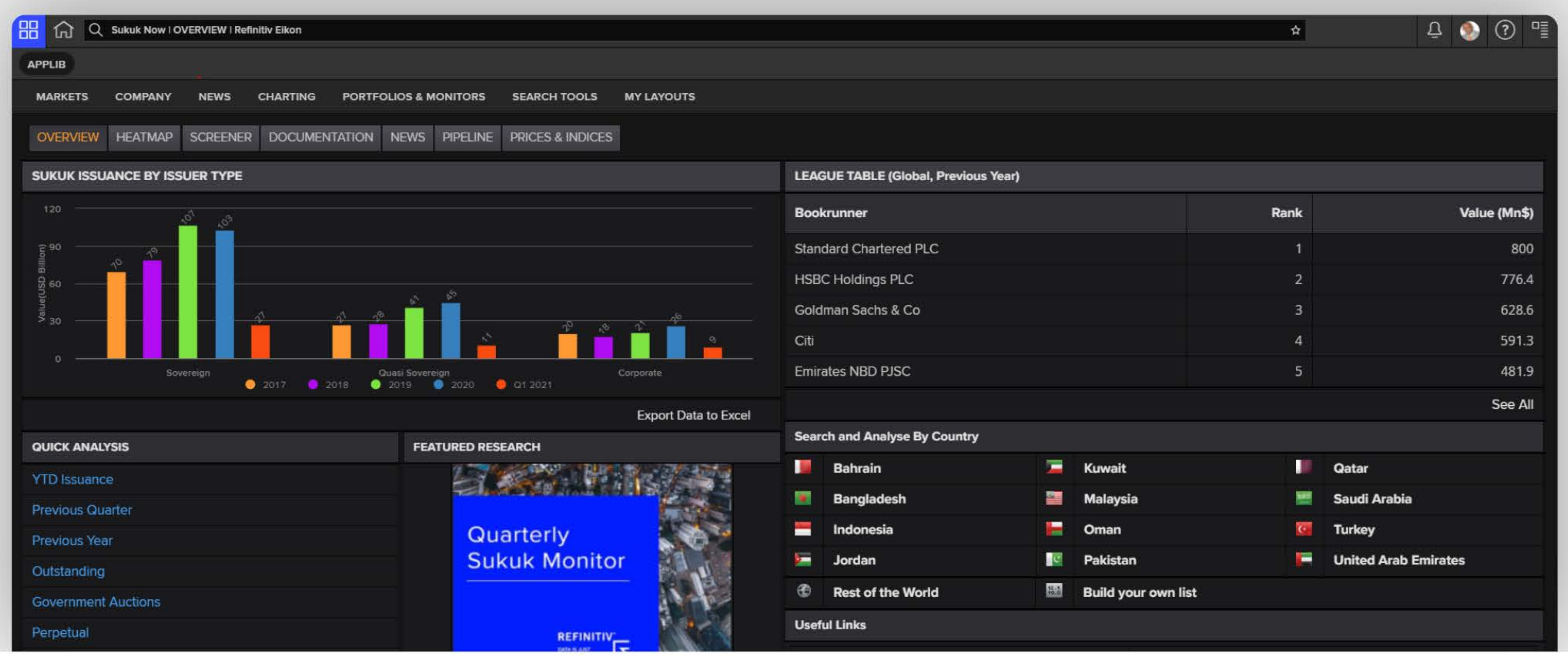
### Change in sukuk allocation in 2022




### State of liquidity in domestic markets

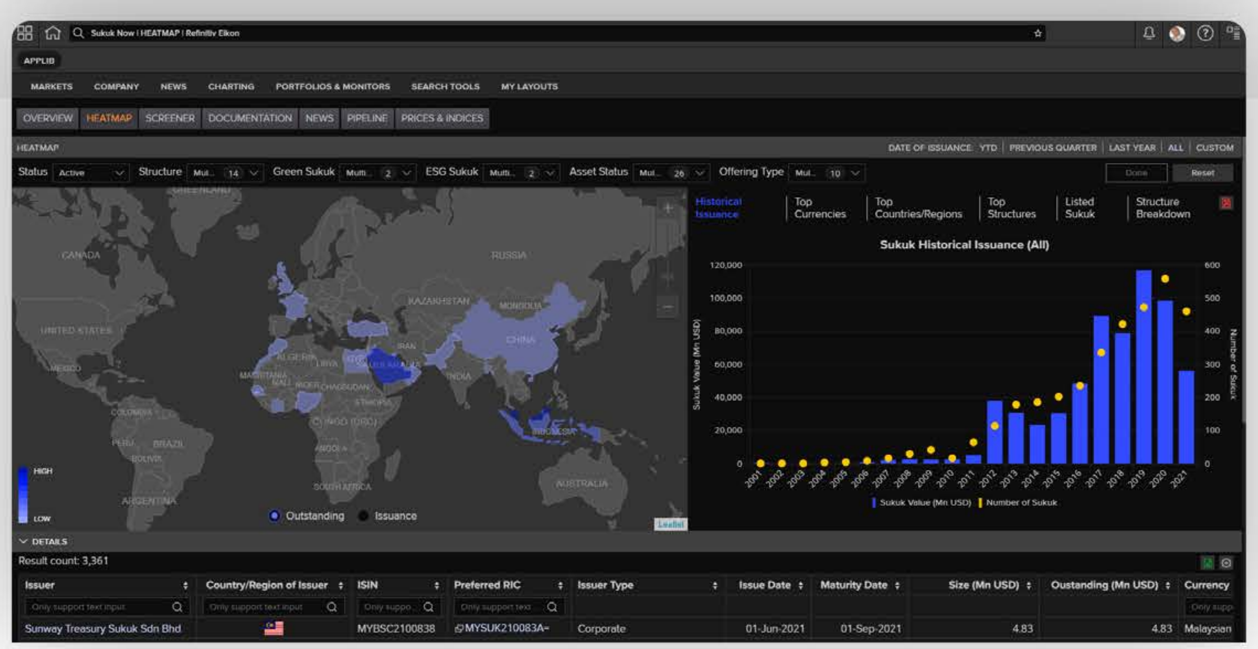


# Never miss a Sukuk beat




**Key features:**

- Simplified screener with advanced analytics: list, charts and breakdown views (new)
- Interactive world heat map for outstanding and issued Sukuk (new)
- All charts and results are customisable and exportable to PDF and Excel (new)
- Breakdown analysis allows for comparison with previous period (new)
- Real-time news feed
- Research, compliance and legal documents
- Price discovery, tradability and liquidity
- League tables, indices and industry benchmarks
- Pipeline and announced Sukuk



**Sukuk Now** is an app on Refinitiv® Workspace/Eikon® offering a 360° overview of the Sukuk market. Via an easy-to-use interface, users can perform quick analysis of the market size and trends; gain deep knowledge about the market and its various structures and transactions; and make informed decisions when it comes to investment in the most sought-after asset class in the Islamic finance industry.

# PRIMARY MARKET

# Sukuk issuance moderates in first half of 2022 after five-year record streak

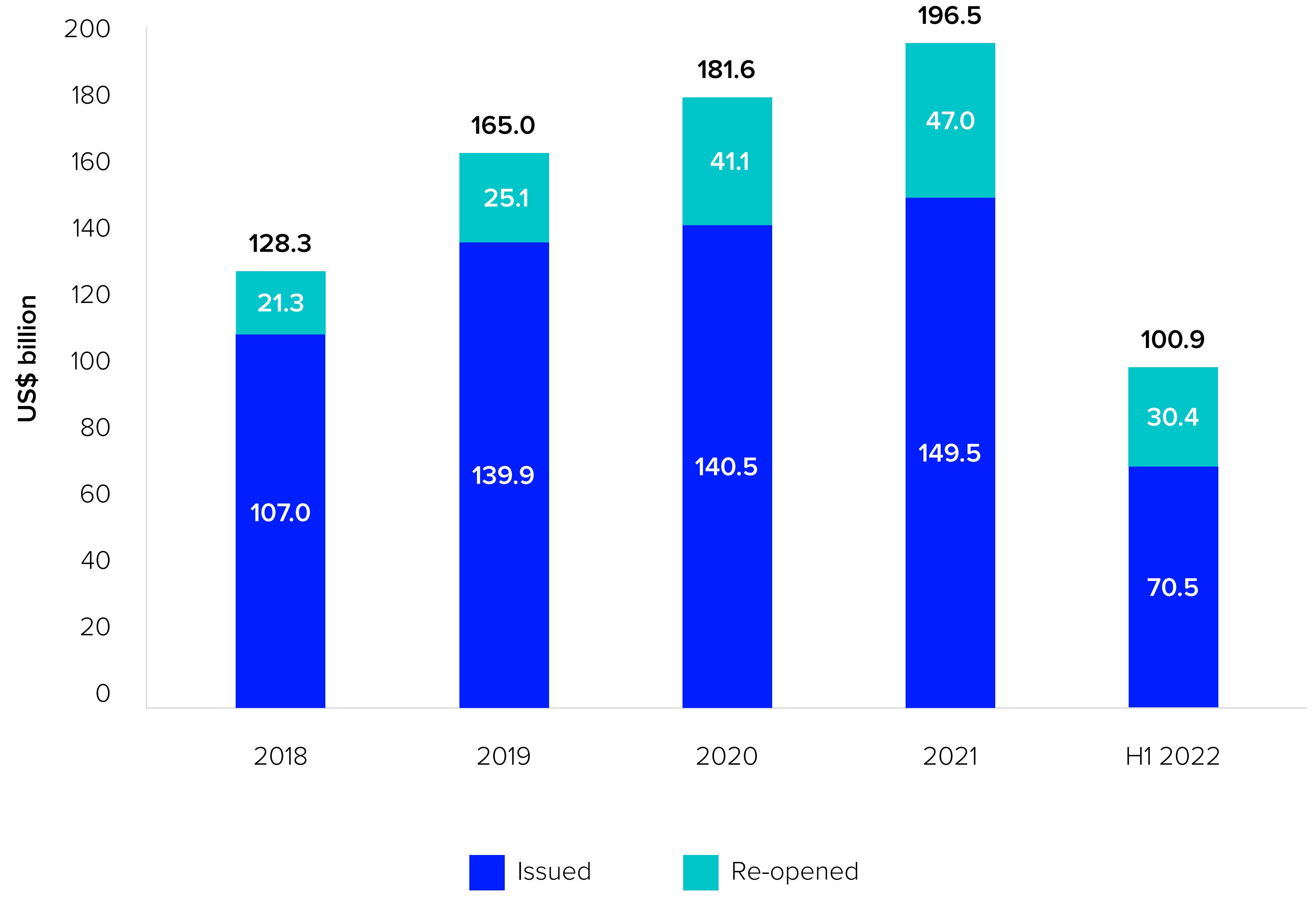
Global sukuk issuance in 2021 set a new record for the fifth consecutive year, reaching a total of $196.5 billion. Although this was a rise of 8.2% from $181.6 billion in 2020, that compares with average annual growth of 21% over previous five years. After issuance built momentum at the start of 2021, it began to slow during the second half of the year as the global economy started its recovery and oil prices strengthened, reducing government borrowing needs in core sukuk markets.

Total sukuk issued in the first half of 2022 amounted to $100.9 billion, marginally lower than $104.2 billion a year before. Excluding a substantial $6 billion issuance from Saudi Aramco in 2021, however, issuance was up 2.6%.

At the start of 2022, the prevailing outlook was that the ongoing economic recovery and high oil prices would reduce government borrowing needs in core sukuk markets within the GCC and Southeast Asia. While these developments had little impact on sukuk issuance in Q1 2022, issuance eventually slowed on the back of multiple interest rate hikes and continued high oil prices.

The slowing in the second quarter was mainly a result of smaller issuances by the Saudi government, whose funding requirements reduced amid soaring oil revenues. The Kingdom reported a $15.3 billion budget surplus in Q1, boosted by a 58% increase in oil income from the previous year. Despite this, the government will continue to curb spending this year, signalling smaller issue sizes ahead.

**Historical sukuk issuance 2018 to H1 2022**




Source: Refinitiv
Note: sukuk data is adjusted to reflect re-opened sukuk and exclude 144A offerings.
Data up to 2021 is restated.

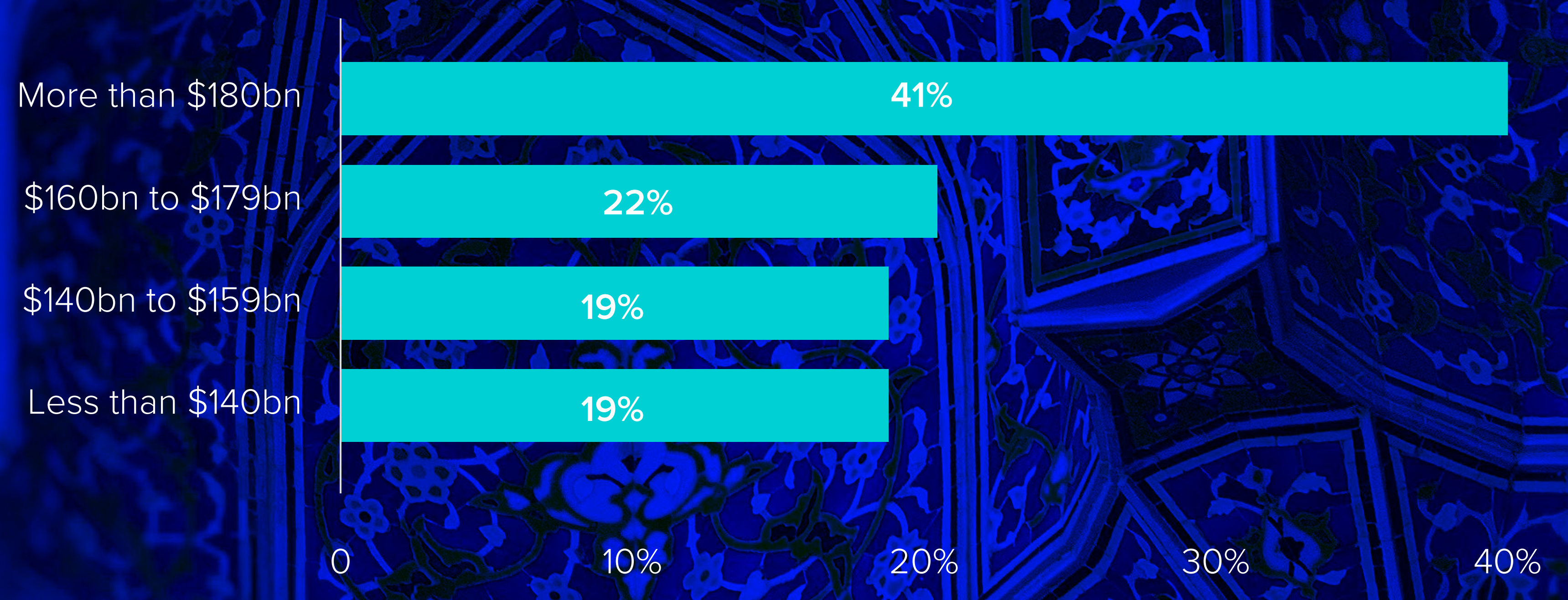
# Survey

At the start of the year, the outlook for sukuk issuance in 2022 was mixed, though leaning towards an overall decline. While 41% of the sukuk survey respondents expected total issuance in 2022 would exceed $180 billion in value, the remaining respondents had a more conservative view that issuance would fall below $180 billion.

As geopolitical tensions heightened and multiple rate hikes loomed, conventional bond issuances slowed and analysts projected a parallel effect on sukuk issuance. Moreover, expectations that oil prices would be sustained above the $100 mark suggested lower borrowing needs and debt issuance from GCC sovereigns, contributing to a slowdown in global sukuk issuance.

However, continued robust demand for sukuk and increasing budgetary pressures on emerging economies such as Malaysia, Indonesia and Pakistan have buoyed global issuance so far in 2022. Mid-year issuances have passed $100 billion, reducing the likelihood of a significant drop over the full year.

**What volume of global sukuk issuance do you expect in 2022?**




Source: Refinitiv sukuk survey

# Saudi issuance rises, while Southeast Asian issuance slows amid economic pressures

Sukuk were issued from entities based in 21 countries in 2021, led by Malaysia with a total $72.6 billion, Saudi Arabia with $49.9 billion and Indonesia with $23.4 billion. These three jurisdictions contributed 75% of sukuk issued in 2022.

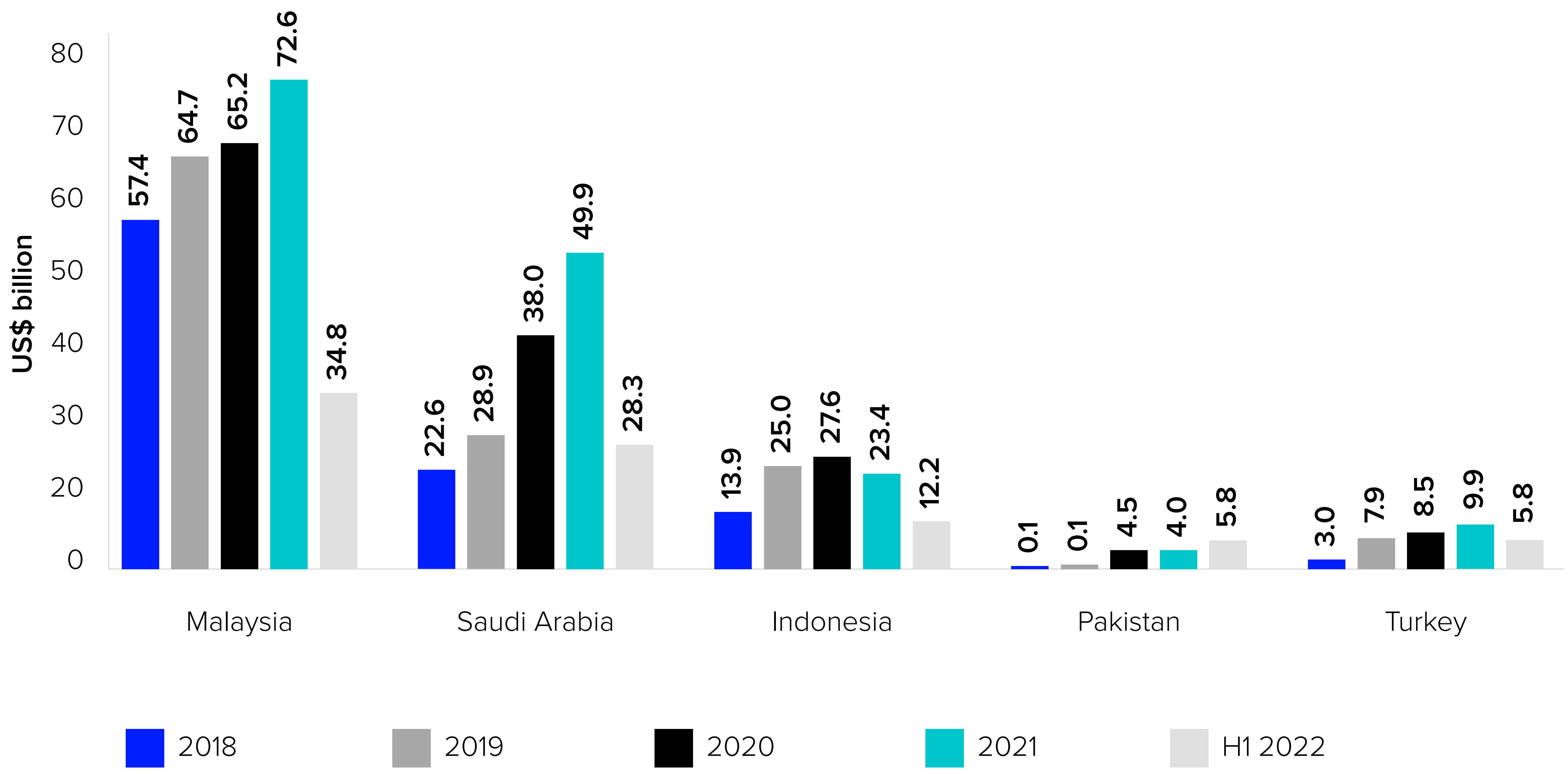
Malaysia maintained its usual lead in terms of annual issuance, but on a quarterly basis it was briefly overtaken by Saudi Arabia in Q4 2021 and Q1 2022. Sukuk from Malaysian issuers dropped to around $15 billion in each of these quarters due to lower corporate issuance, before corporate activity picked up in Q2 2022. Malaysia-based issuers raised $34.8 billion in H1 2022, 14% lower than in H1 2021.

Saudi sukuk issuance activity slowed during the second quarter as the government reduced the size of its monthly domestic issues. Still, Saudi-based issuers raised $28.1 billion during H1 2022, compared with $24.2 billion during the same period in 2021. Indonesia remained the third-largest issuance base, although activity in its domestic market slowed further from record levels in 2020 due to lower budget funding requirements.

Returning to the market after six years, the Senegalese government raised CFA330 billion ($525.4 million) for financing the acquisition of government buildings, among other projects. This was the sovereign's third issuance since its market debut in 2014.

Sukuk issuance from Egypt continued for the third consecutive year, consolidating its status as an emerging sukuk jurisdiction. To date, Egyptian corporates have issued sukuk totalling $657.6 million. However, the country's debut sovereign sukuk expected in Q1 2022 was postponed yet again, to the fiscal year ending in June 2023. The decision came as risk metrics highlighted a high likelihood of default on sovereign debt, as bond yields reached 13%.

**Leading countries by sukuk issuance 2018 to H1 2022**




Source: Refinitiv
Note: sukuk data is adjusted to reflect re-opened sukuk and exclude 144A offerings.
Data up to 2021 is restated.

# Feature

## Pakistan returns to sukuk market to bolster economic stability

With Pakistan's foreign reserves continuing to deplete through international debt repayments, the government returned to the international sukuk market for the first time since a five-year dollar sukuk was issued in 2017.

In January 2022, the sovereign raised $1 billion from the sale of a seven-year sukuk on the Eurobond market. The issue will cost the government 7.95% in profit payments, the highest return ever offered in Pakistan's sukuk borrowing history in international markets. Even so, the sovereign was able to negotiate pricing down from a benchmark rate of 8.25% to 8.375%, supported by the potential for robust long-term economic growth, as well as ongoing structural reforms to improve power sector performance and in revenue mobilisation, fiscal consolidation and debt management. The government used portions of the M2 motorway linking Lahore to Islamabad as the underlying assets for its sukuk.

The motivation for the issuance, despite the steep borrowing cost, was to strengthen the country's foreign exchange reserves in advance of some large foreign loan repayments. These reserves have come under pressure as Pakistan's external account deficit widened due to a surge in commodity – mainly oil – prices at the same time as the rupee depreciated after a market-based exchange rate was adopted in 2021.

International debt repayments and servicing existing debt will require a total of $21 billion in the 2022-23 fiscal year, in addition to at least $15 billion required to cover the current account deficit plus $1 billion covering other financing needs. This $37 billion addition to the existing debt burden limits Pakistan's options for raising debt, making it no longer prudent to tap global capital markets.

As interest rates increased, creating unfavourable pricing conditions for Pakistan in international bond markets, the government issued an additional $4.8 billion in the domestic market, raising the H1 2022 total to $5.8 billion. The sovereign announced in June that it would become a more active sukuk issuer as part of measures to achieve economic stability. The State Bank of Pakistan (SBP) plans to raise PKR85 billion ($383.5 million) during Q3 2022 through Ijara sukuk issued on the domestic market. It has pledged the use of several federal assets, including the Islamabad Expressway, to back upcoming sovereign sukuk issuances.

Looking ahead, the government aims to issue sukuk under its Asset Light Sukuk (ALS) framework unveiled in 2021, whereby sukuk can be issued using hybrid structures not entirely backed by land or property. By these means, it is hoped to increase the share of Islamic instruments from 3.9% in the 2020-21 fiscal year to at least 10% of the government securities portfolio by the end of the 2022-23 fiscal year as part of the government's Medium-Term Debt Management Strategy 2020-23. The government aims to tap debt markets more regularly through this scheme, which may reduce the cost of issuing sukuk.

# Sovereigns still dominate issuance; corporate issuance slows amid rate pressures

Governments remain the main driver of sukuk issuance, with sovereigns having maintained a share of around 60% of global issuance since 2017. Sovereign sukuk issued in 2021 totalled $119.9 billion, of which 87% was issued by GCC, Malaysian and Indonesian governments. These sovereigns accounted for 83% of the $68.8 billion in total global sovereign issuance in H1 2022.

With the economies of core sukuk markets gaining strength as pandemic restrictions subside and oil revenues persist at high levels, sovereign sukuk issuance is largely expected to slow through the remainder of 2022. Nonetheless, some governments could maintain, or potentially increase, issuance levels as they channel funding towards mitigating the impact of rising inflation.

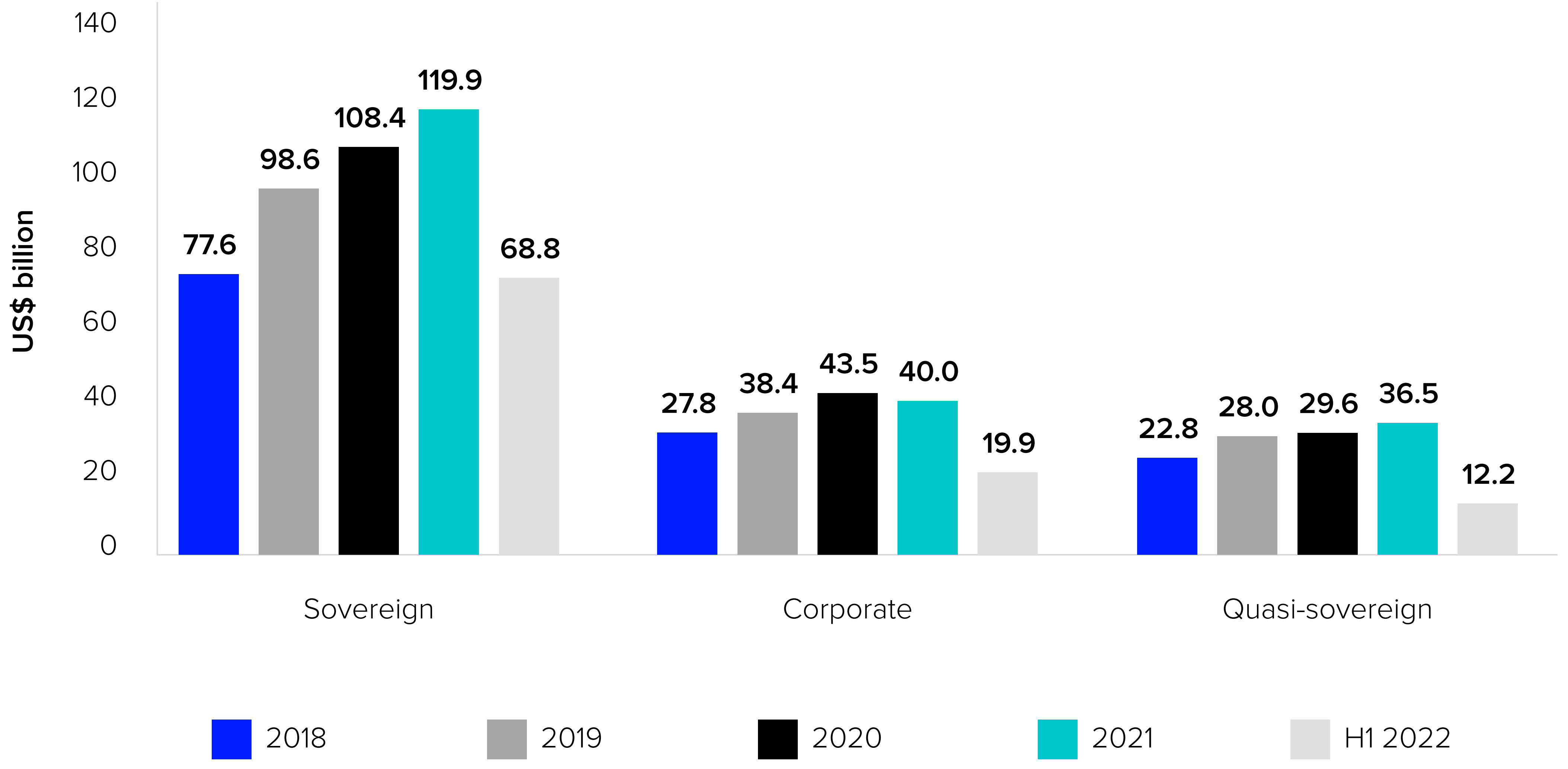
The Saudi government was the largest sovereign issuer in H1 2022, holding on to the position it acquired in Q3 2021. Despite oil prices reaching their highest levels since the global financial crisis, the Saudi government ramped up issuance to tap into strong demand for debt from highly rated issuers. The sovereign raised $22.1 billion during H1 2022, compared with $9.9 billion in H1 2021. Issuance included a $7 billion sukuk in March to help consolidate domestic public debt under the country's sukuk programme.

Corporate issuance amounted to $19.9 billion in the first half of 2022, down 7.8% from the same period the previous year on the back of rapidly increasing interest rates. Corporate issuances are likely to taper further towards the end of 2022, with expectations of as many as seven Fed rate hikes across the year.

Financial institutions typically account for the majority of corporate sukuk issuance, contributing 65% of the $38.1 billion global total in 2021. GCC banks saw exceptional demand for their sukuk in Q1 2022. Saudi National Bank's $750 million sustainability-linked issue was oversubscribed more than four times, while Al Rajhi Bank upsized its own sukuk issuance to $1.7 billion, historically the largest by a financial institution, due to unprecedent demand, with bids coming from more than 600 investors.

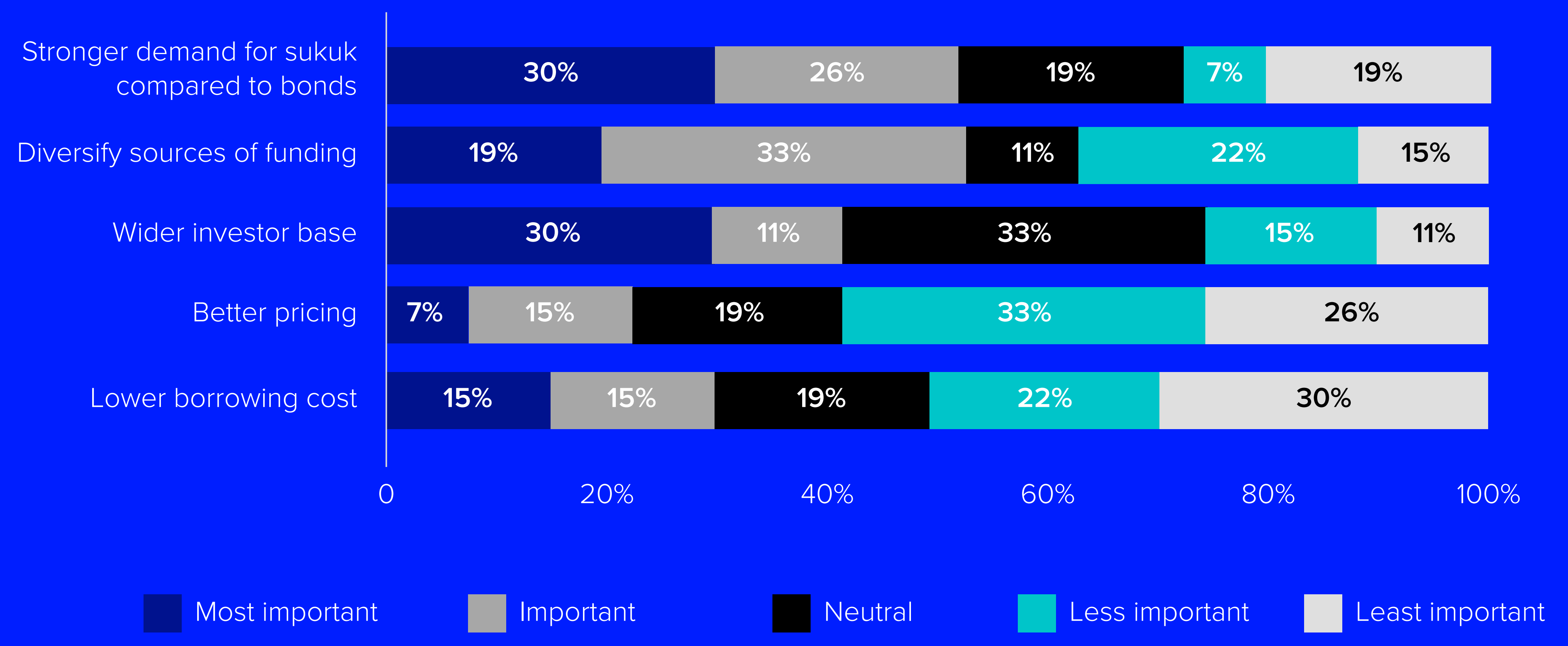
Quasi-sovereign issuances nearly halved to $12.2 billion in H1 2022 from the same period of the previous year. The difference stemmed from the $6 billion sukuk issued by Saudi Aramco in 2021 and a slowdown in issuance from the Islamic Development Bank, which issued its first Secured Overnight Financing Rate (SOFR)-linked sukuk in Q2 2022, at $1.6 billion.

**Sukuk issuance by issuer type 2018 to H1 2022**




Source: Refinitiv
Note: sukuk data is adjusted to reflect re-opened sukuk and exclude 144A offerings.
Data up to 2021 is restated.

**Rank the following as primary reasons for prospective sovereign issuers to consider sukuk over other means of financing.**




Source: Refinitiv sukuk survey

# Survey

Diversifying sources of funding and broadening the investor base are commonly cited by governments and other issuers as reasons to issue sukuk. The asset-backed nature of sukuk makes them more stable than conventional bonds during periods of high volatility and so can lower the risk profiles of fixed income portfolios. Sovereigns are also able to reach a wider investor base by reaching investors that follow an exclusively Shariah-compliant mandate.

Over 50% of survey respondents cited strong demand for sukuk and diversifying sources of funding as important reasons for new sovereign issuers to tap the sukuk market. Lower borrowing costs and better pricing were seen as the least important reasons for issuing sovereign sukuk. However, these can be seen as natural outcomes of the strong demand for sukuk. This strength of demand, as demonstrated by oversubscribed issuances, allows issuers to negotiate lower profit payments (cost of borrowing). High demand is also conducive to better pricing.

Recent examples include a $3 billion dollar sukuk issued by the Turkish government that racked up an order book of $10.75 billion, which then sold at 7.25%, below initial guidance of between 7.5% and 7.625%. Similarly, Pakistan issued a $1 billion sukuk that attracted more than $3 billion in bids, subsequently selling at 7.95% after the sovereign was able to negotiate pricing down from an even higher benchmark rate of 8.25% to 8.375%.

# Feature

## Garuda's default renews concerns over enforceability of bankruptcy resolution

The economic uncertainty created by the Covid-19 pandemic also led to some defaults on sukuk and non-payments of profit, and as a result renewed concerns over how such disputes will be resolved. The highest-profile such case was the default of Garuda, Indonesia's state-owned national airline, on a profit payment on its $500 million sukuk in 2021. With airlines grounded in 2020 by the pandemic, Garuda had narrowly avoided defaulting on the sukuk, originally due in 2020, by extending its maturity by three years. In 2022, as part of its proposed $9.8 billion debt restructuring plan, Garuda paid sukuk holders a recovery rate of 19 cents on the dollar, combined with converting a third of the debt into equity.

Two other Indonesian issuers – state-owned construction consultancy Indah Karya and real estate developer Prima Jaringan – have missed periodic payments. Elsewhere, Emirates REIT, the UAE's largest Shariah-compliant real estate investment trust and Malaysian engineering services firm Serba Dinamik Holdings have also shown some default risk, resulting in recent downgrades from Fitch Ratings. In May 2022, Serba Dinamik defaulted on a $222.2 million sukuk due for repayment upon its maturity that month. It also defaulted on ringgit-denominated debt after missing a payment in the same month, citing the impact of Covid-19 on operating conditions.

The few sukuk defaults that have occured so far were mostly resolved out of court. However, the Garuda default renewed concerns regarding ambiguity around how sukuk defaults in the sector are resolved. There have been calls for more effective bankruptcy resolution systems in order to provide better protection for sukuk holders and more certainty around recovery prospects.

Legal precedent for effective enforcement in Islamic financial jurisdictions is lacking and different jurisdictions have different court mechanisms for sukuk defaults. Malaysia's advanced sukuk ecosystem includes a centralised body for Shariah law and a high level of industry standardisation, allowing it to deal with sukuk defaults in a comparable way to bonds. Indonesian law, on the other hand, authorises Islamic financial dispute resolutions to be handled by domestic religious courts, although in practice disputes can be settled in commercial courts.

Bankruptcy regimes in different countries are at various stages of development, but they are mostly still at an early stage and largely untested. Many jurisdictions have updated their bankruptcy laws in recent years, but it remains to be seen how bankruptcy courts treat defaults on sukuk when compared to bond defaults, whether investors will have full recourse to the issuers and whether sukuk certificate holders will be able to enforce their contractual rights in local courts.

In addition to a limited track record of court resolutions, the sukuk market lacks standardisation at both domestic and global levels, which has led to complications in court resolutions as well as Shariah risk. In 2017, a default by UAE-based energy company Dana Gas on its $700 million sukuk led to worries about enforceability among global sukuk investors. The spotlight fell on Shariah risk when a UK court ruled that obligations under the sukuk were binding and Dana Gas had to pay its sukuk investors, overturning a ruling by a UAE court that the sukuk were no longer Shariah-compliant due to changes in local interpretations of Islamic finance, and therefore there was no longer an obligation to pay. The case was eventually resolved out of court with a restructuring deal.

Although the development and standardisation of global, legal and regulatory frameworks governing sukuk markets are at early stages, the uncertainties surrounding sukuk defaults have not hampered investor appetite, which remains robust.

# International markets less attractive to sukuk issuers as high rates loom

Sukuk issued in international markets totalled $52.2 billion in 2021, compared with $47.1 billion in 2020. However, the momentum of international sukuk issuance, mainly in the Eurobond market, slowed in 2022 despite strong activity from issuers capitalising on high demand from international investors earlier in the year.

Interest rates are rapidly increasing, with three hikes taking the Fed benchmark rate to a target range of 1.5% to 1.7% during the first half of 2022. As a result, dollar sukuk amounted to $22 billion in H1 2022, down 10% from $33.2 billion over the same period a year before as issuers concentrated their borrowing in domestic markets and the tightening policy strengthened the dollar.

While corporate dollar sukuk increased, sovereigns relied on borrowing from domestic markets in the first half. The governments of Turkey, Pakistan, Indonesia and the Emirate of Sharjah were the only sovereigns to issue international sukuk, collectively raising $8 billion. Meanwhile, a single $1 billion issuance sufficed for the Islamic Development Bank, a normally regular sukuk issuer in international markets.

Federal Reserve economists project further increases will lift the benchmark rate to 3.25% to 3.5% by the end of the year, which will likely deter some issuers from international markets. Still, despite increasing costs for dollar debt, issuers supported by positive long-term outlooks could negotiate more favourable rates. In addition, investors' shift to higher-yielding investments has increased their appetite for risk, which in turn has benefitted sukuk issuers rated below investment grade.

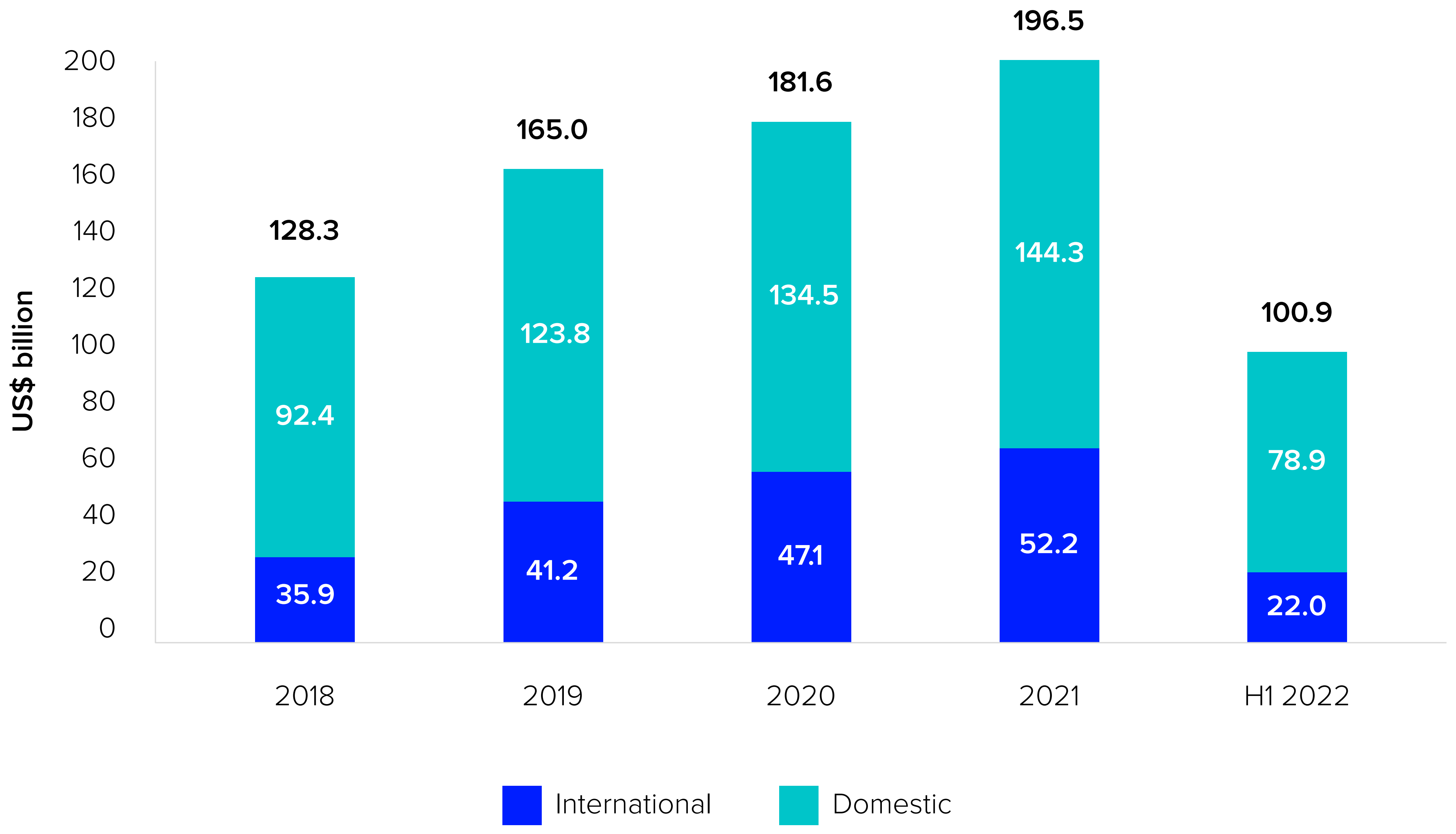
Elsewhere, Malaysia maintained its global lead as the largest domestic market, hosting 30% of total sukuk issued in 2021. However, sukuk issued in Malaysia's domestic market dropped from $31 billion in H1 2021 to $27.5 billion as corporate issuance fell by 17%.

Indonesia's domestic market has also slowed since the end of 2020, with a 19% drop in issuance to $20.4 billion in 2021. Rupiah-denominated issuance continued to decline in H1 2022, down 20% compared to a year prior.

Meanwhile, Saudi riyal issuances totalled $24.9 billion in H1 2022, almost double the $12.9 billion total of H1 2021. The domestic market was boosted by the ramp-up of government issuance in Q1.

Pakistani rupee sukuk were the fifth most issued in H1 2022, in terms of currency, raising $5.8 billion in total. The Pakistani government had announced in June that it would become a more active issuer in sukuk markets as part of measures to achieve economic stability.

### Sukuk issuance by market of issue 2018 to H1 2022



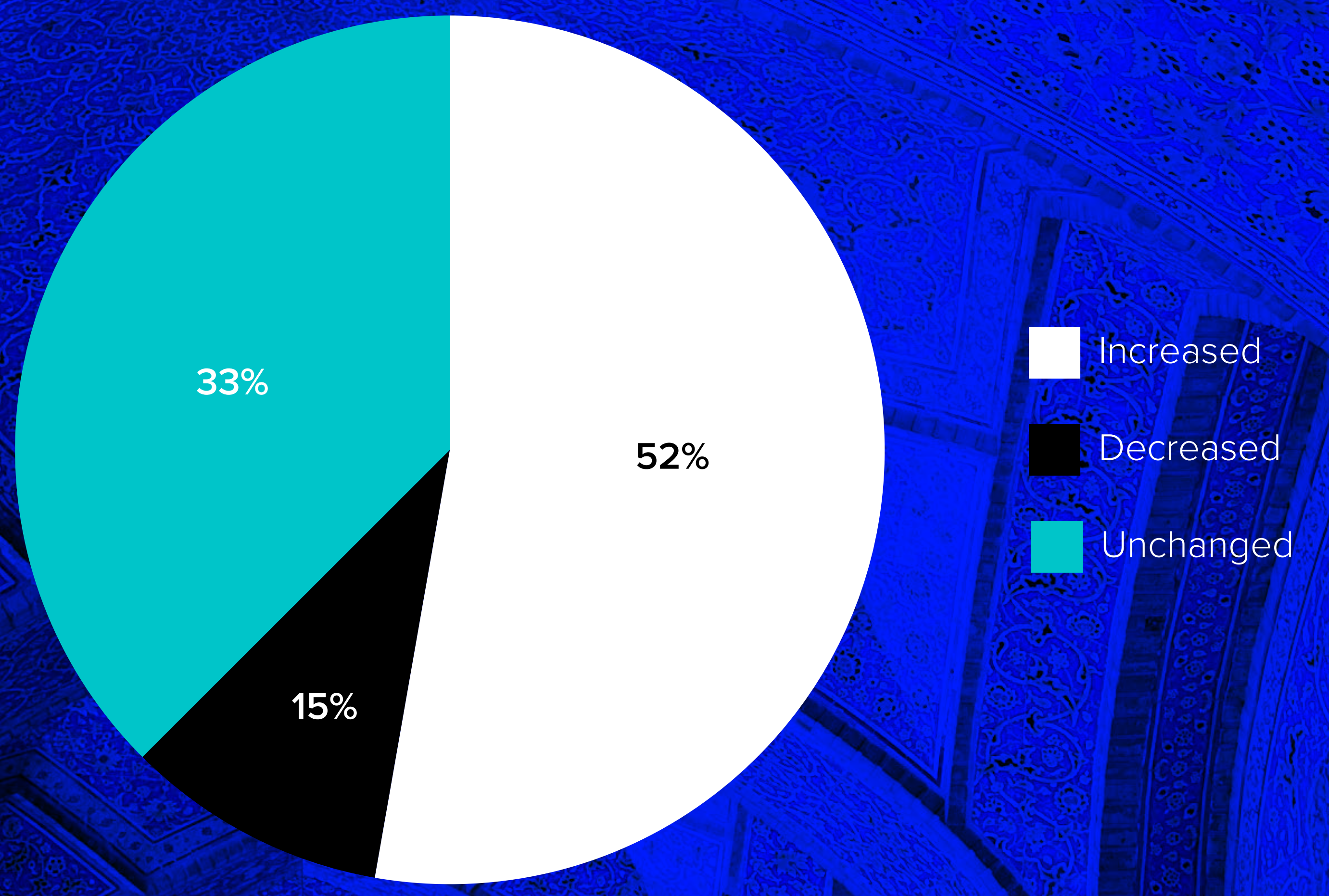

Source: Refinitiv
Note: sukuk data is adjusted to reflect re-opened sukuk and exclude 144A offerings.
Data up to 2021 is restated.

Sukuk issued in domestic markets increased by 56% between 2018 and 2021, boosting liquidity in core sukuk markets. Domestic issuances noticeably increased in Malaysia, Saudi Arabia, Turkey, Indonesia and Pakistan during this period. These markets accounted for 84% of sukuk outstanding in H1 2022.

More than half of survey respondents agreed that domestic currency issuances improved as sukuk issuance increased in the past two years, substantially expanding the sukuk investment pool (sukuk outstanding).

Also, 33% of respondents noted that liquidity remained unchanged in domestic sukuk markets, while 15% said liquidity declined as demand continues to outpace supply, forcing investors to hold sukuk to maturity. Either observation would apply to the majority of sukuk markets that are smaller or less developed, with low issuance activity, while the boost to liquidity was concentrated in a handful of markets.

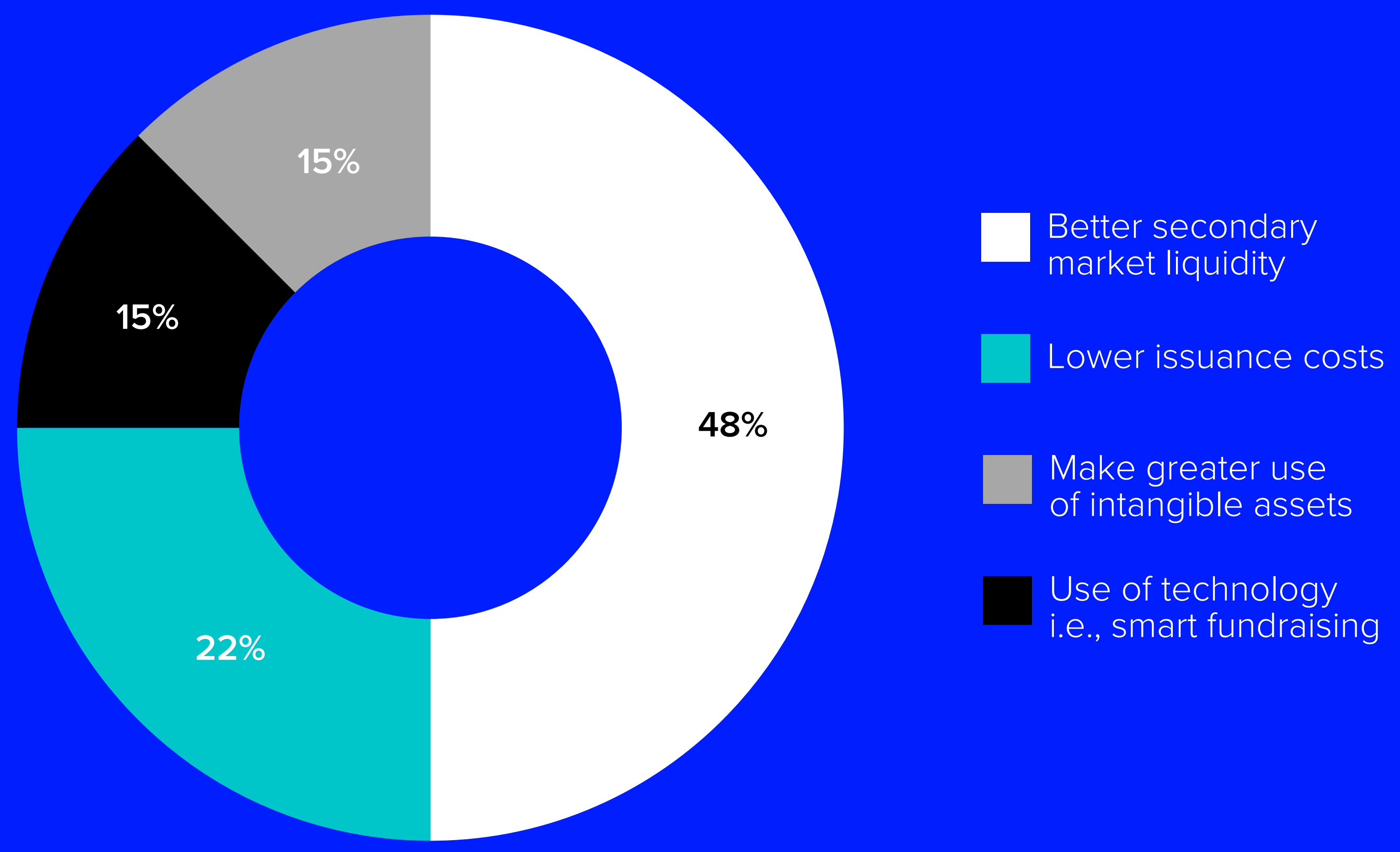
**How has liquidity evolved in domestic (local currency) Sukuk markets over the past five years?**




Source: Refinitiv sukuk survey

# Survey

**How can Sukuk become more appealing to potential new Sukuk issuers?**




Source: Refinitiv sukuk survey

Poor liquidity in secondary markets for sukuk when compared with conventional bonds continues to be the main bottleneck for new issuers, according to nearly half the survey's respondents. Although the sukuk supply-demand gap is narrowing, the shortage in viable Shariah-compliant investments compels most investors to follow a buy-and-hold approach with sukuk.

However, increasing issuance activity in some of the largest sukuk markets has considerably improved secondary market liquidity, making these markets more attractive to non-traditional sukuk issuers. Currently, the Eurobond market is considered the most attractive for new sukuk issuers coming from conventional bond markets, as it offers access to a more liquid market and a huge international investor base.

The second most-mentioned incentive that could raise sukuk's attractiveness for potential issuers is lower issuance costs, which could be addressed mainly by streamlining sukuk issuance processes and standardising documentation and applicable Shariah standards. Fewer respondents believed the use of financial technology (fintech), such as blockchain and smart contracts, would make the sukuk market more attractive to corporates, small-to-medium enterprises (SMEs) and small government agencies, which tend to shy away from bond or sukuk markets because of high issuance costs. The use of technology does have the potential to streamline the sukuk issuance process and reduce the cost of issuance, however, thus making small issuances more cost effective.

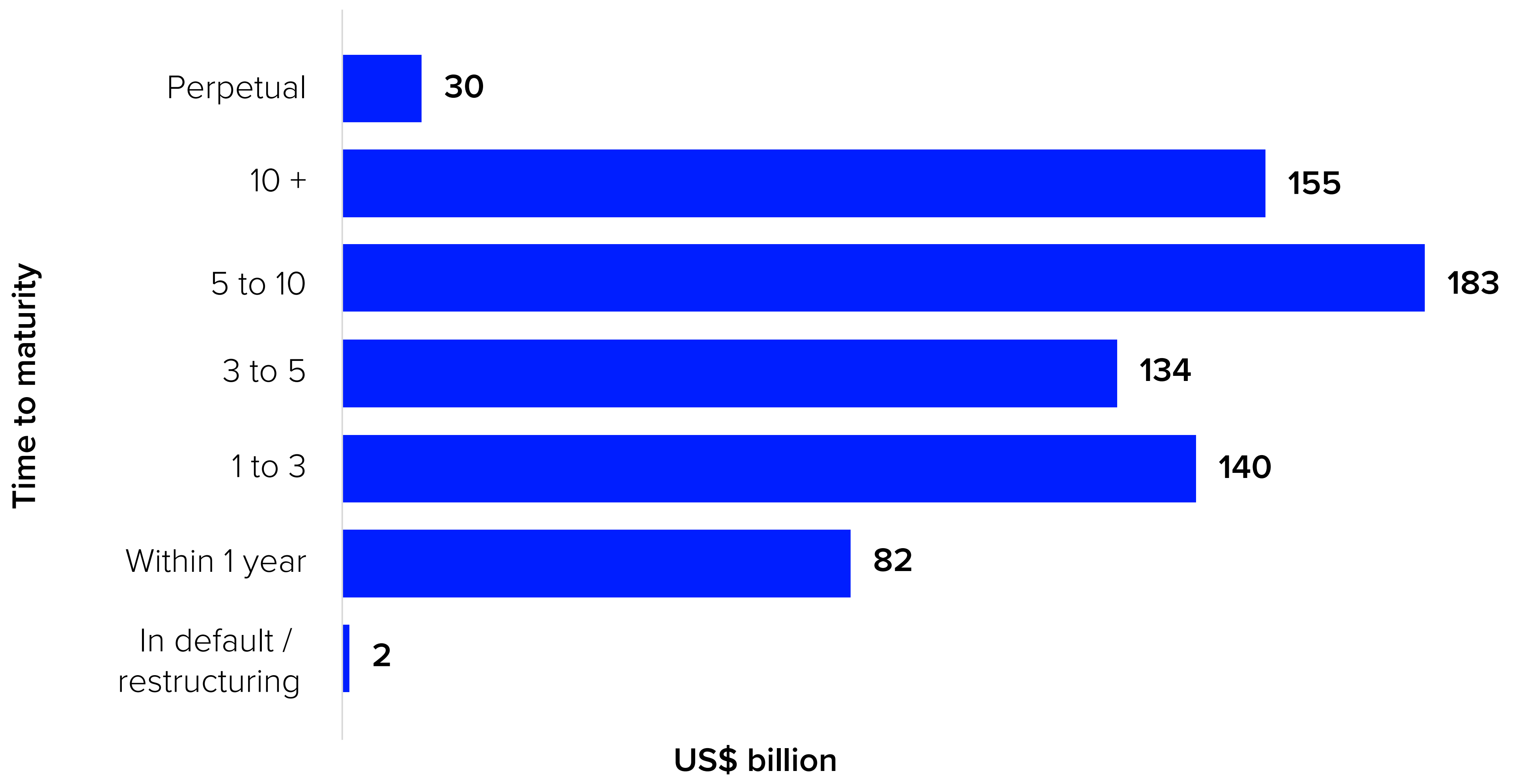
# SECONDARY MARKET

The global secondary market for sukuk continued to expand as growth in issuance maintained the momentum built over the past five years. The value of sukuk outstanding reached $726.3 billion in H1 2022, up 4.4% from the end of 2021.

The secondary sukuk market is highly concentrated within three jurisdictions – Malaysia, Saudi Arabia and Indonesia – which together accounted for 80% of the value of sukuk outstanding in H1 2022. Malaysia is the largest secondary sukuk market, accounting for 39% of the total.

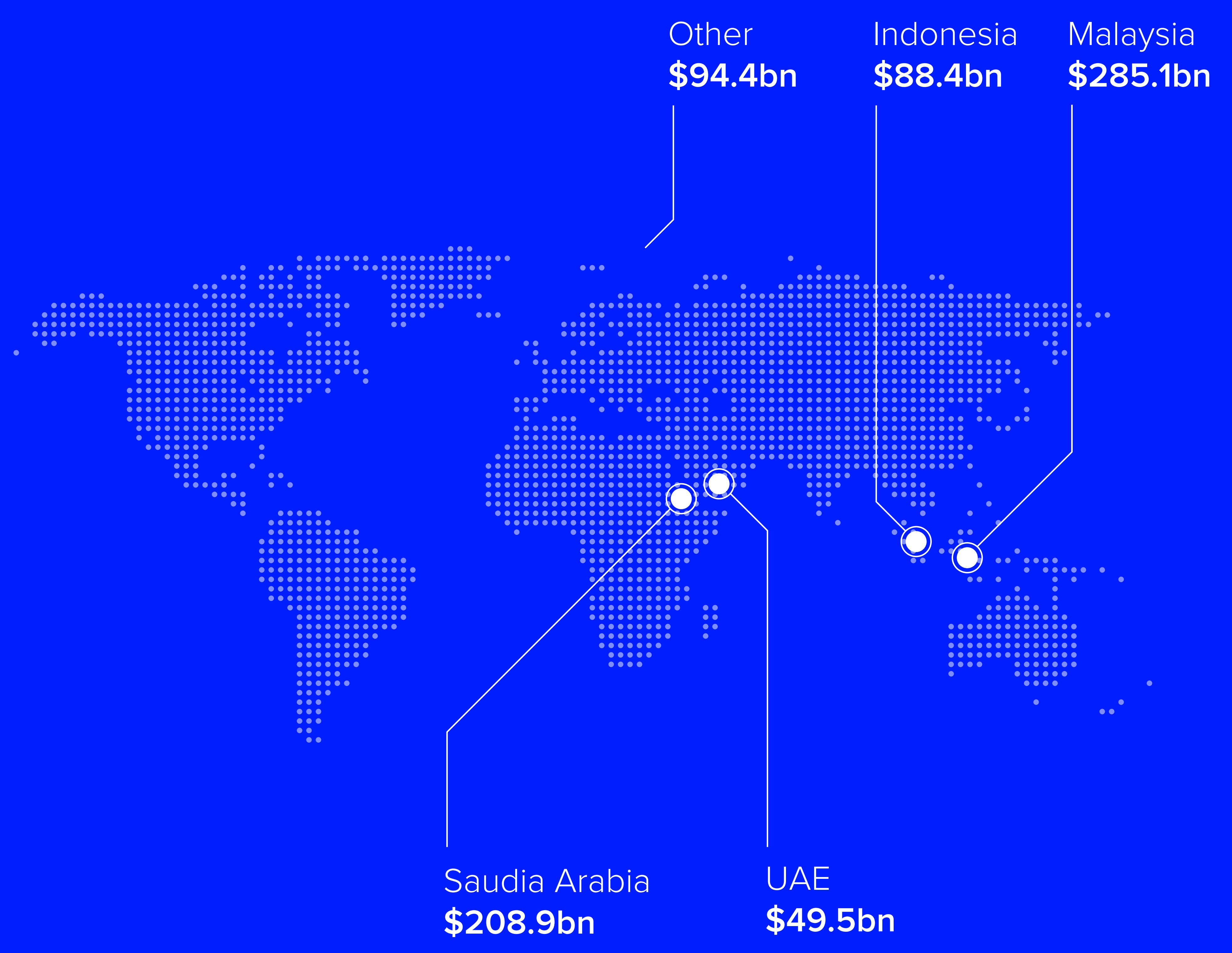
Around 30.6% ($222.2 billion) of the outstanding sukuk will mature within the coming three years. This includes $40 billion due for repayment by the end of 2022, most of which will need to be refinanced.

### Sukuk maturity profile as of H1 2022




Source: Refinitiv
Note: sukuk data is are adjusted to reflect re-opened sukuk and exclude 144A offerings.

### Global sukuk outstanding by country as of H1 2022




Source: Refinitiv
Note: sukuk data is are adjusted to reflect re-opened sukuk and exclude 144A offerings.

# Sukuk secondary market resilient as emerging market debt markets dip

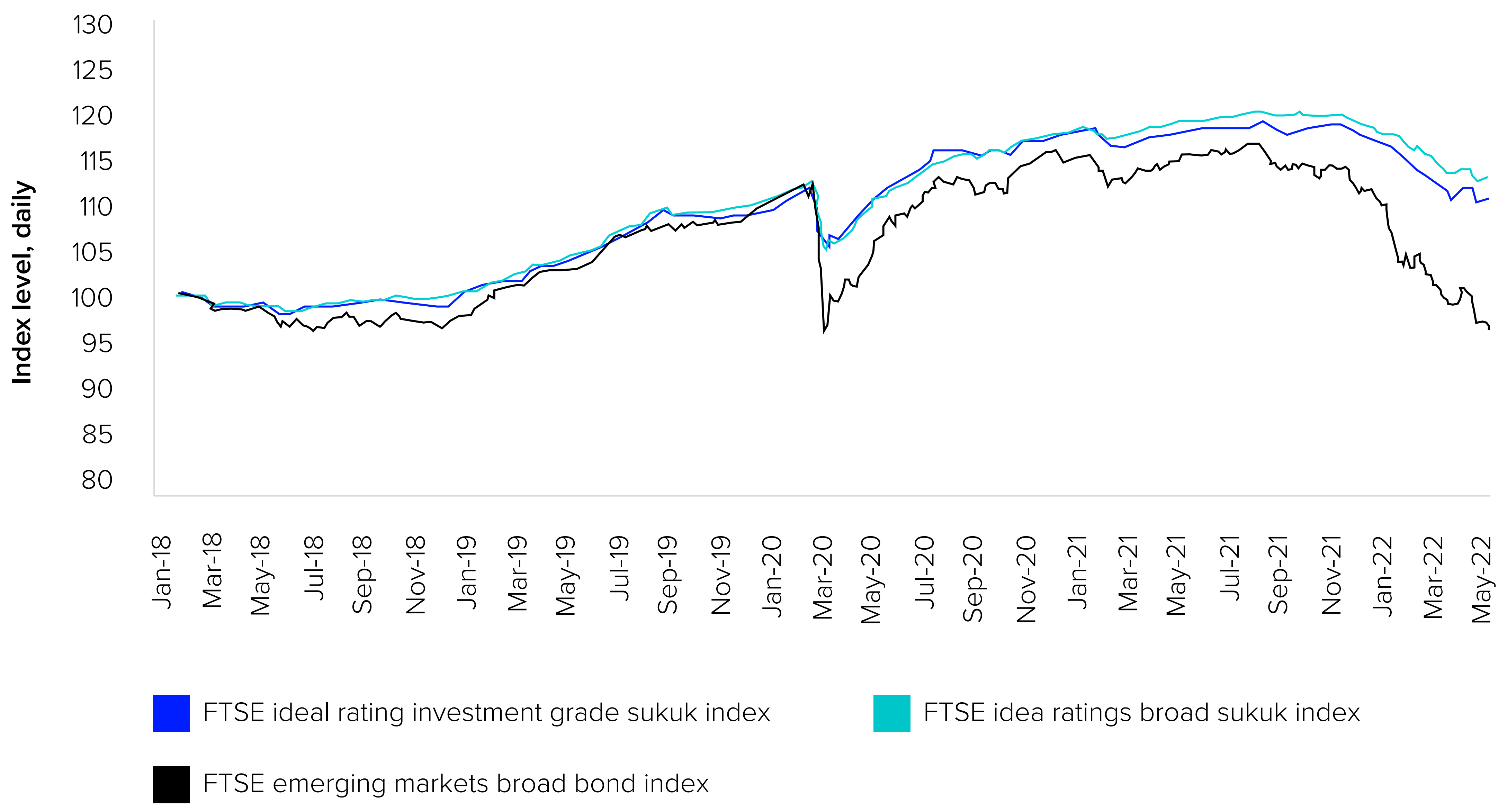
Rising borrowing costs, driven by the Federal Reserve's newly hawkish stance, together with inflation pressures and the economic fallout of the conflict in Ukraine, have left emerging market bonds in the crosshairs of a crisis. The asset class has suffered one of its worst sell-offs in recent history as it underperformed most fixed income markets. In 2022, the FTSE Emerging Markets Broad Bond Index had its worst start to a year in 25 years.

Sukuk markets, however, have demonstrated much more resilience, with the largest markets supported by a boom in oil and commodity prices after they plummeted in 2020. Also, most sukuk issuers in core markets have little direct exposure to the Ukraine conflict.

As shown by a comparison of the performance of the FTSE IdealRatings sukuk indices with the FTSE Emerging Markets Broad Bond Index, the secondary sukuk market has historically showed greater resilience to economic shocks than have conventional bonds. Sukuk indices have outperformed emerging market bonds so far in 2022, due largely to their higher weighting of oil exporters.

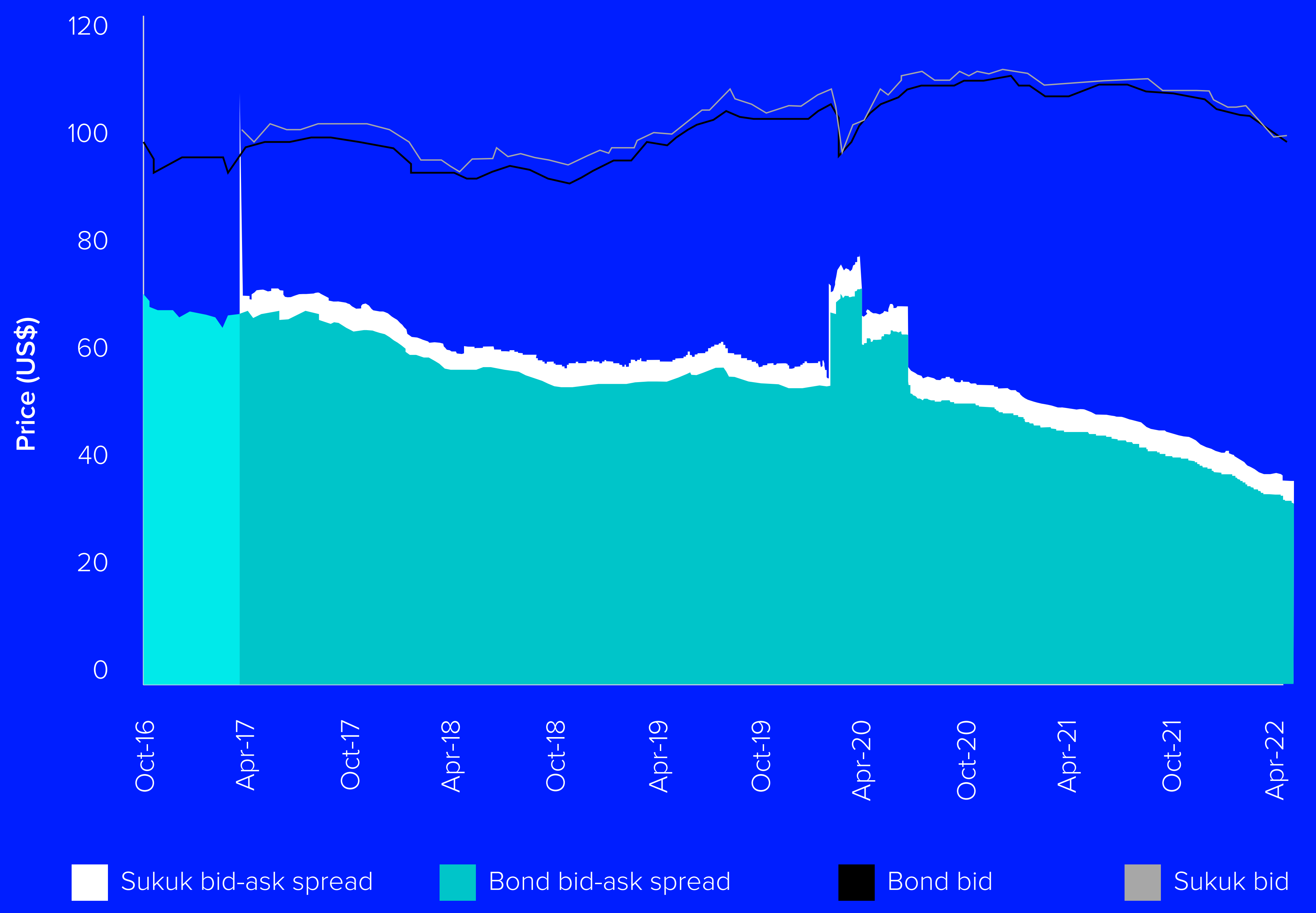
Emerging market debt had tumbled in March 2020 as the Covid pandemic took hold. Sukuk prices on the secondary market fell to a lesser extent, however, with the least impact felt by investment-grade issuances.

**Sukuk vs. emerging market bond indices performance 2018 to H1 2022**




Source: FTSE Russell

**Performance of Saudi sovereign bond vs. sukuk in the Eurobond market**




Source: Refinitiv

# Feature

## Saudi sukuk closely matching bond performance in Eurobond market

Due to the shortage in supply, sukuk investments are typically held to maturity, resulting in lower liquidity than for conventional bonds. Sukuk thus tend to have wider spreads.

A comparison between a 10-year dollar bond and comparable sukuk issued by the Saudi government in 2016 and 2017 shows the sukuk's price and level of liquidity have closely tracked those of the bond.

By the end of H1 2022, bid-ask spreads on both debt instruments had tightened by more than 40 basis points since issuance, indicative of greater liquidity and demand for both instruments despite recent economic developments. While the sukuk's liquidity position improved, it remained less favourable than the bond. The sukuk spread remained wider than the bond's, by an average of 2.4 basis points.

Spreads spiked during the first half of 2020 as volatility in global markets, caused by the Covid pandemic, slowed trading activity. Liquidity returned as markets settled with the start of the Covid vaccination campaigns, with spreads on both the sukuk and bond continuing to tighten.

The prices of both instruments track closely, with the sukuk consistently priced higher than the bond. The price differential reduced from $3.1 at issuance to an average of $1.4 during H1 2022. After a dip in Q1 2020, prices recovered to exceed pre-Covid levels. Subsequently, both instruments remained priced at a premium, gradually decreasing from the start of 2022 and reflecting increasing interest/discount rates in the first half of the year.

# International sukuk liquidity stable

Bid-ask spreads for comparable dollar sukuk from major issuers of credit ratings narrowed slightly, but for the most part remained stable during H1 2022. This reinforces the observation of lower volatility for sukuk compared to other debt instruments.

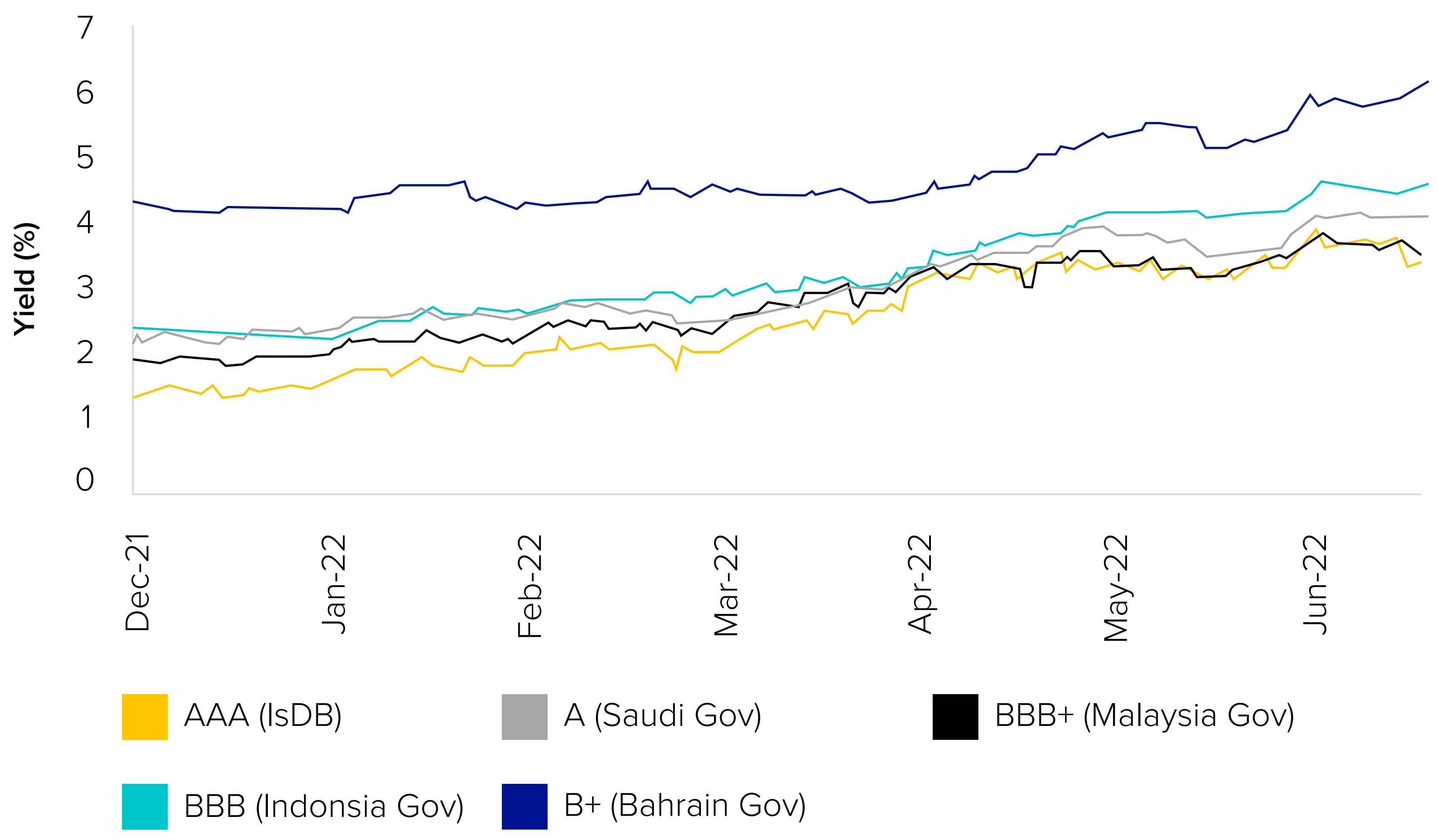
Sukuk issued by higher-rated issuers had the lowest spreads and therefore the highest liquidity in the group.

The spread on the Saudi sovereign sukuk has been fluctuating around 40 basis points since January 2022. Meanwhile, the spread on the IsDB sukuk tightened from 14 basis points in December 2021 to 11.3 basis points at the end of June 2022, indicating greater liquidity during this period. In contrast, the spread on the Indonesian sovereign sukuk remained near constant at 100 basis points, indicating considerably lower liquidity.

Meanwhile, yields on these sukuk increased during H1 2022 due to increases in policy rates during this time. Yields will continue to increase, in line with benchmark rates, which will boost demand from non-traditional sukuk investors seeking high-yield bond investments. While yields on conventional bonds in developing markets are also increasing, almost all sukuk fall under emerging market debt, which offers higher yields, although sukuk tend to be more resilient.

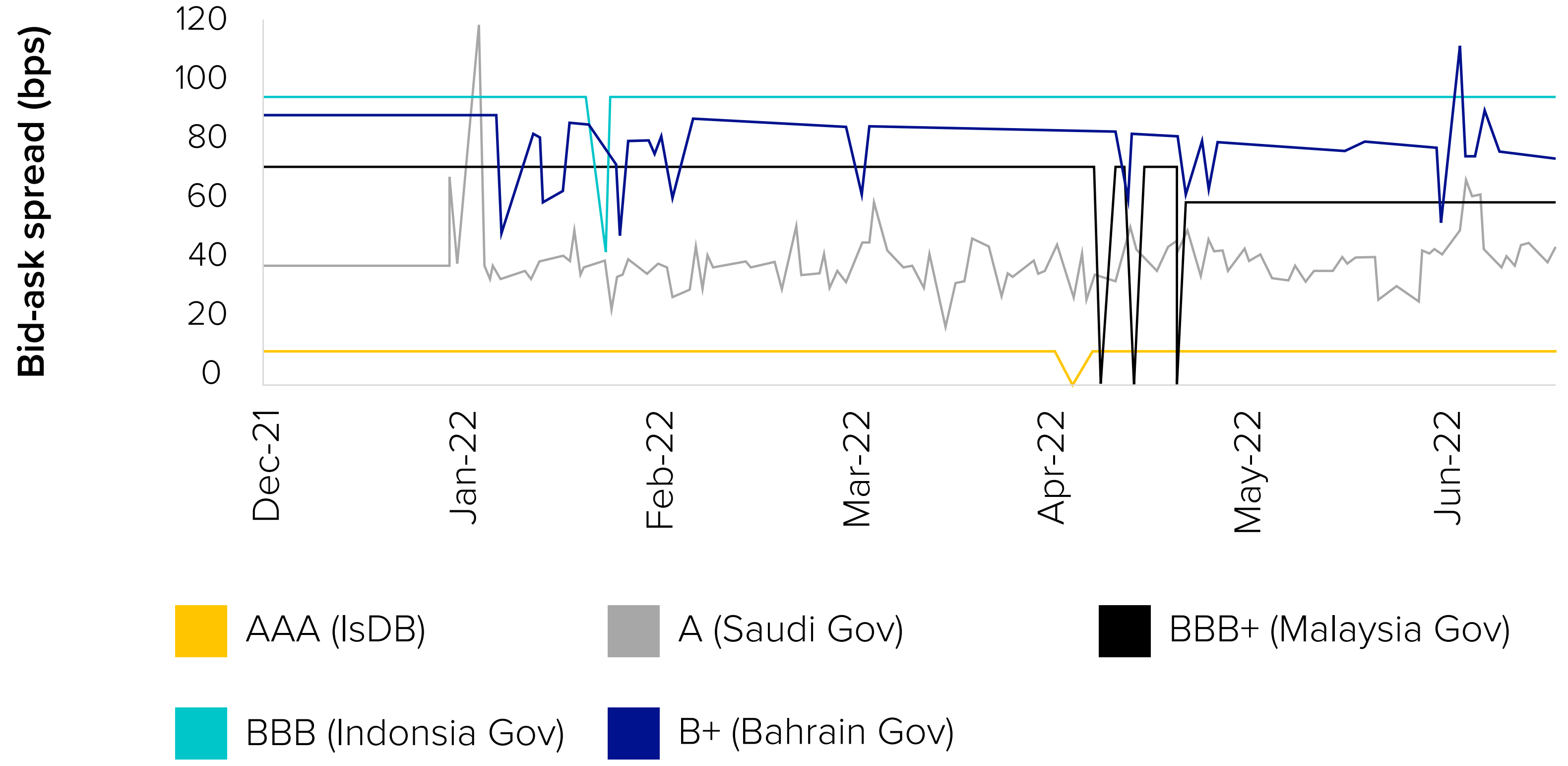
Source: Refinitiv

**Yield by issuer rating Dec 2021 to June 2022**




Source: Refinitiv

**Bid-ask spreads by issuer rating Dec 2021 to June 2022**




Source: Refinitiv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# GLOBAL SUKUK OUTLOOK

# Stable outlook for sukuk supply despite global headwinds

The initial outlook for the sukuk market in 2022 was for issuance activity to moderate due to expectations of continued economic recovery and high oil prices. Six months in, several looming risks have become full-blown global crises. The International Monetary Fund has warned the global economy faces an "outlook that has darkened significantly". The risk of recession is magnified for 2022 and is expected to worsen in 2023.

## GCC issuance to slow as oil prices remain high, pending more stable conditions

While the fallout from the Ukraine conflict seemed to have a muted impact on global sukuk issuance, its indirect impact on the market has so far been more pronounced. The conflict has contributed to a rally in oil prices, which has replenished the coffers of GCC sovereigns and left most with budget surpluses this year.

However, with most GCC economic visions coming to term by 2030, there are a number of strategic infrastructure projects either underway or being revived. Issuances supporting these projects will likely be offered once volatility abates in global financial markets. In particular, several ESG issuances from Saudi Arabia's Public Investment Fund (PIF) and the Saudi and Qatari governments are in the pipeline, awaiting more conducive issuance conditions. As a result, sukuk issuance from GCC jurisdictions will likely remain flat at best, pending better conditions for issuance.

## Mixed pressures from increasing inflation and policy rates

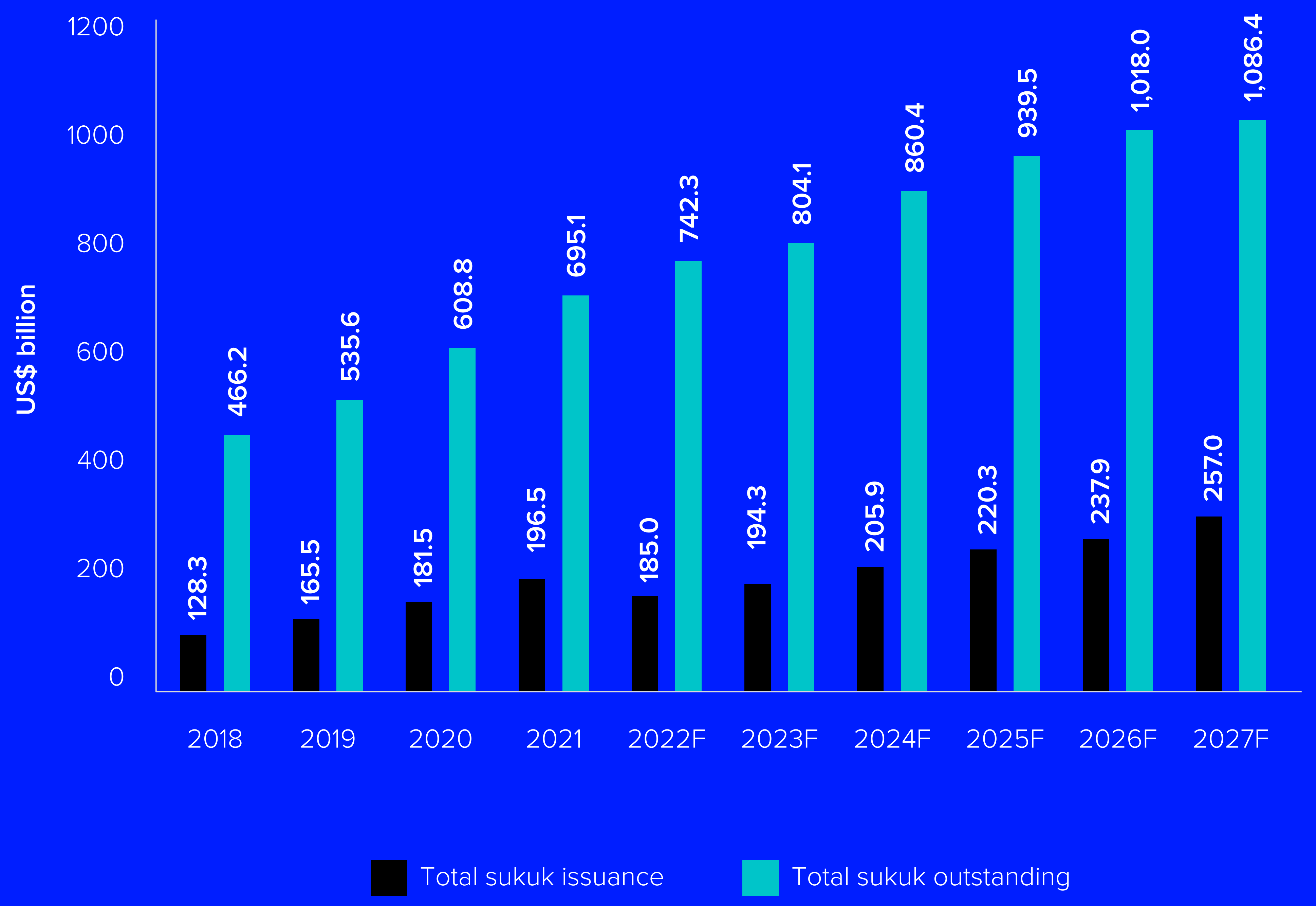
Meanwhile, commodity price shocks resulting from the Ukraine conflict are slowing economic growth and intensifying inflationary pressures in other key markets, mainly Malaysia and Indonesia. Inflation has reached multi-decade highs in most countries, triggering a global monetary tightening cycle.

By the end of H1 2022, the Federal Reserve had raised its benchmark rate to between 1.5% to 1.75%, and this was raised again in July, to a range of 2.25% to 2.5%. Policy rates in key sukuk markets — GCC, Malaysia and Pakistan – increased in tandem. Meanwhile, Bank of Indonesia has maintained its benchmark rate at a record low of 3.5% since February 2021, relying on heavy subsidies to bring inflation under control. In Turkey, policy rates have been maintained since December 2021 following a series of rate cuts, which unintendedly exacerbated inflation to 80%.

Despite efforts to mitigate fast-rising prices, inflation remains the biggest threat to economic recoveries in Malaysia and Indonesia. Both countries introduced subsidies and cash assistance programmes to support vulnerable households, which will increase pressure on government budgets. This, however, will ensure that these sovereigns remain active in capital markets, providing some buoyancy to sukuk issuance up to the end of the year.

While analysts expect sovereign issuance to maintain its pace, corporate issuances are expected to moderate amid a less conducive capital-raising environment. Yet as economic activity resumes, the anticipation of further policy rate hikes may persuade corporate issuers to bring forward bond issuances in order to lock in lower rates, led by issuers in financial services, infrastructure and utilities.

## Sukuk supply 2018 to 2027F




Source: Refinitiv sukuk supply and demand model

## Sukuk issuance to regain momentum in long-term

As geopolitical tensions have heightened and multiple rate hikes loom, conventional bond issuances have slowed and analysts are projecting a parallel effect on sukuk issuance. However, continued robust demand for sukuk and growing budgetary pressures on emerging economies such as Malaysia, Indonesia and Pakistan have buoyed global issuance so far in 2022. Mid-year issuances have passed $100 billion, reducing the likelihood of a significant drop in issuance over the full year.

According to the Refinitiv Sukuk Supply and Demand Model, issuance is projected to settle at $185 billion by the end of 2022. This estimate is largely in line with market expectations and the sukuk survey results, where 41% of respondents indicated they were still bullish about growth in global sukuk supply, expecting issuance to reach $180 billion or more in 2022.

Looking further ahead, issuance is projected to grow at an estimated compound annual growth rate of 6.8% over the next five years, reaching $257 billion in 2027, according to the Refinitiv Sukuk Supply and Demand Model.

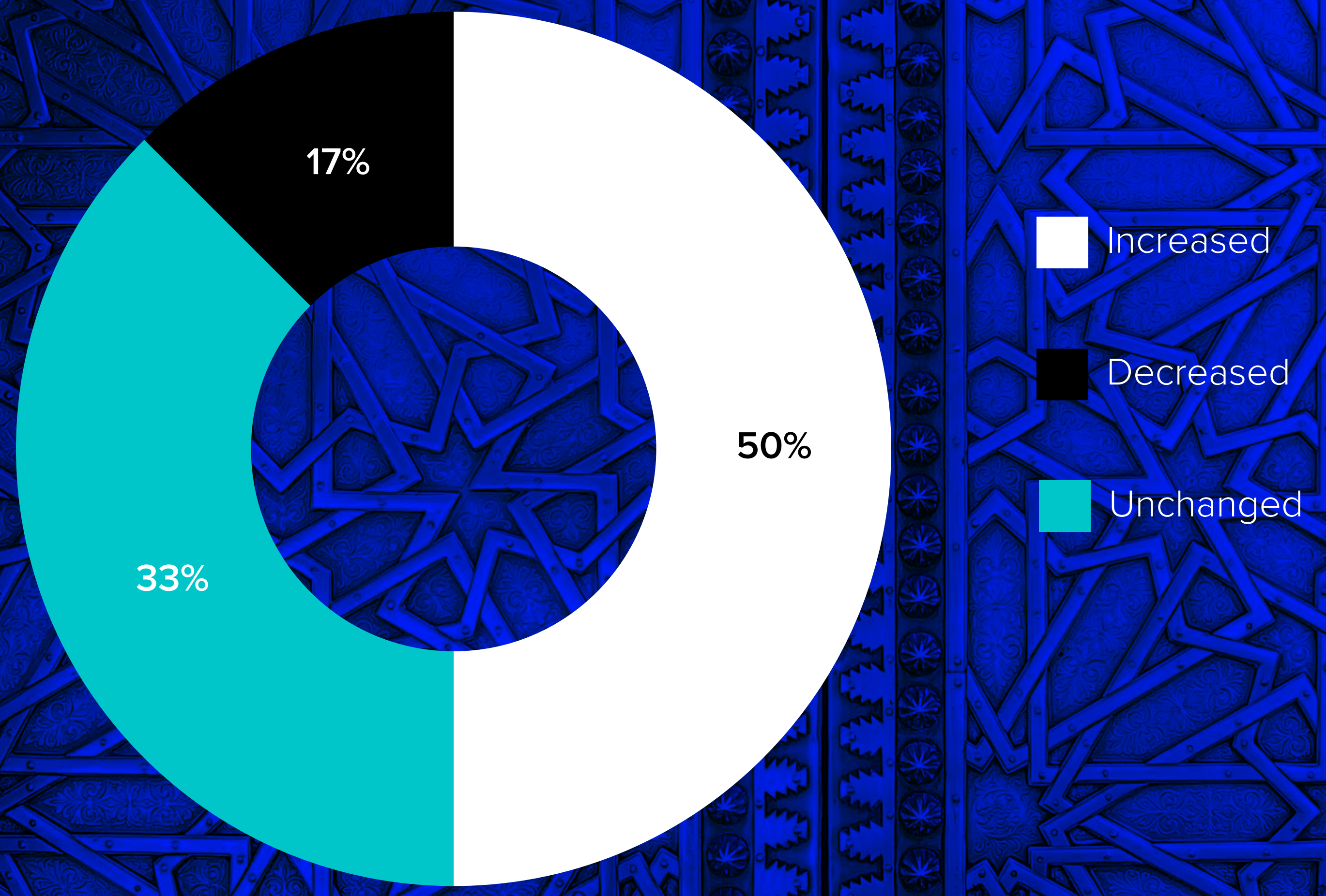
Sukuk supply, defined by total sukuk outstanding, reached $726.8 billion in H1 2022 and is projected to reach $742.3 billion by the end of the year.

# Survey

When asked about the impact of market conditions on their sukuk investments, 50% of survey respondents said the sukuk allocations in their Shariah-compliant portfolios increased in 2022, while 33% said they did not change.

Despite a substantial sell-off of emerging market debt earlier in 2022, demand for sukuk investments remained strong, and is projected to increase in a high-policy-rate environment. The resulting higher yields and lower prices, as well as higher profit pay-outs, stand to attract more demand from sukuk investors.

**How are economic conditions impacting the Sukuk allocation in your Islamic portfolio in 2022?**




Source: Refinitiv sukuk survey

# Demand for Sukuk to remain strong, focused on domestic markets

Demand for sukuk comes primarily from institutional investors, particularly Islamic banks and other Islamic financial institutions such as takaful providers and asset managers, whose mandates restrict their portfolios to Shariah-compliant investments. Demand from these investors remains fairly stable, even during unfavourable market conditions, because of the limited Shariah-compliant investment pool available to them.

However, looking more specifically at the non-Shariah-sensitive investor base, assumed to account for 50% of total demand, rapidly increasing interest rates are impacting their demand for sukuk and shifting the supply-demand dynamics in the market. Generally, sukuk offer appealing risk-return profiles, generating higher yields with lower volatility relative to comparable fixed income securities. This is evidenced by previous comparisons between the performances of sukuk and emerging market debt during recent global political and economic shifts.

## Higher returns attracting more demand for sukuk

Higher yields on sukuk, caused by increasing benchmark rates, have invited bargain-hunting, which is boosting demand in domestic sukuk markets. As demonstrated earlier in this report, prices of sukuk that traded at a premium earlier in 2022 fell below par as rate increases began late in March, offering attractive deals to investors.

Moreover, higher pay-outs or coupons offered on new sukuk issuance are attracting increasing demand from institutional investors, especially fund managers and takaful operators that typically hold investments. This higher coupon income offsets the losses from price declines to a greater extent than it did in 2021.

## Stronger dollar concentrates demand in domestic markets

Dollar sukuk saw strong demand during Q1 2022, which helped these issuers secure more favourable, albeit still high, pricing. The Turkish government racked up an order book of $10.75 billion for its $3 billion issuance in February 2022. Elsewhere, Pakistan’s $1 billion international sukuk attracted more than $3 billion in bids.

However, as the dollar strengthened, driven by a newly-aggressive monetary tightening policy, emerging debt markets saw huge sell-offs and foreign investment outflows. Return differentials between debt in developed versus emerging markets, including sukuk, led international investors to return to developed debt markets. While some of these investors will return to the sukuk market seeking still higher yields, demand will be driven mainly by investors in domestic markets.

## Preference for short-term sukuk, potentially widening supply-demand gap

Expectations of further rate increases are shifting investor preference towards short-term sukuk in order to avoid interest rate risk, allowing them to reinvest at lower sukuk prices with higher pay-outs. On the other hand, issuers will prefer to issue longer-term sukuk to avoid committing to higher pay-outs, which presents the risk of widening the supply-demand gap for sukuk.

The rise of ESG sukuk is another avenue attracting non-Shariah-sensitive investors to the sukuk market. But issuance in this space may slow as concerns have been raised by market analysts that green and sustainability projects could take a back seat while oil prices remain high.

**Methodology: estimating sukuk demand (2021)**

| | |
|---|---|
| Total Islamic finance assets excluding. Sukuk | **$2,942bn** |
| | **x** |
| Average proportion of liquid assets and sukuk held to maturity by IFIs | **14%** |
| | **=** |
| Demand from Shariah-sensitive investors | **$411.85bn** |
| | **+** |
| **Demand from non-Shariah-sensitive investors**. Assumed at least equal to Shariah-sensitive demand | **$411.85bn** |
| | **=** |
| | **Total sukuk demand** **$823.7bn** |

Source: Refinitiv

## Demand projections

The Refinitiv Supply and Demand Model measures estimated demand for sukuk using a top-down methodology. Two types of investor power demand for sukuk: Shariah-sensitive investors, and non-Shariah-sensitive global investors seeking attractive yields and diversification benefits in an uncertain post-pandemic landscape.

The analysis makes two assumptions. Firstly, it assumes that demand from Islamic Financial Institutions (IFIs) is a suitable proxy for Shariah-sensitive demand, since IFIs make up the vast majority of Shariah-sensitive sukuk investors.

Second, the model assumes that demand for sukuk from non-Shariah-sensitive investors is at least equal to demand from Shariah-sensitive investors, judging by the quantum of global fixed-income assets that already exist. According to the Refinitiv sukuk survey, lead arrangers who responded estimated that 50% of demand for sukuk comes from non-Shariah-sensitive investors.

According to Refinitiv estimates, total Islamic finance assets excluding sukuk amounted to $2.94 trillion in 2021. This figure is multiplied by the average proportion of liquid assets and sukuk held to maturity by IFIs, which is estimated at 14%. The result provides a figure for total demand for sukuk from Shariah-sensitive investors of $411.9 billion.

The second assumption, the number for total demand for sukuk from non-Shariah-sensitive investors, is also $411.9 billion, based on primary research and insights gathered from lead arrangers. Therefore total demand for sukuk in 2021 is estimated at $823.7 billion.

# Sukuk supply–demand gap expected to widen as issuance lags strong demand

The Sukuk supply and demand model estimates that demand for sukuk will remain flat at $823.7 billion by the end of 2022, and grow by a compounded annual growth rate of 7.6% to reach $1.2 trillion in 2027. Sukuk supply is projected to grow slightly faster. The size of the sukuk market is expected to reach $742.3 billion by the end of 2022 and $1.1 trillion in 2027, growing at a 7.9% compounded annual growth rate.

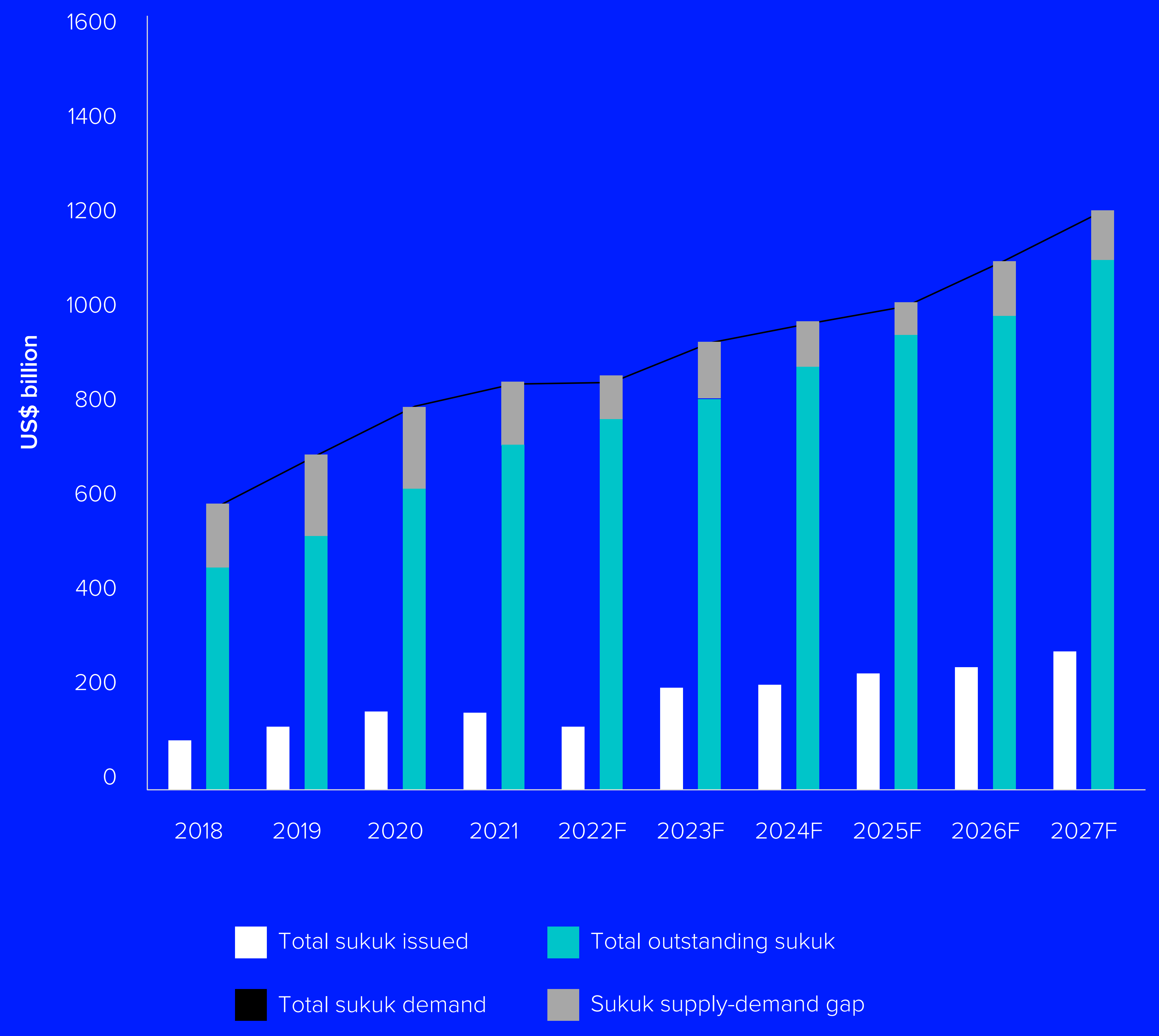
The model thus projects the supply-demand gap to narrow to $81.4 billion in 2022 and then expand to $101.4 billion in 2027, as the growth in sukuk supply considerably slows down from double-digit growth during the past five years. This would be mainly due to 52% of presently outstanding sukuk maturing by the end of 2027.

### Sukuk supply and demand equilibrium 2018 to 2027F

| US$ billion | 2018 | 2019 | 2020 | 2021 | 2022F | 2023F | 2024F | 2025F | 2026F | 2027F |
|---|---|---|---|---|---|---|---|---|---|---|
| Total sukuk issuance | 128.3 | 165.5 | 181.6 | 196.5 | 185.0 | 194.3 | 205.9 | 220.3 | 237.9 | 257.0 |
| Total sukuk supply | 466.2 | 525.8 | 608.8 | 695.1 | 742.3 | 804.1 | 860.4 | 939.5 | 1,018.0 | 1,086.4 |
| Total sukuk demand | 592.4 | 682.8 | 774.3 | 823.7 | 823.7 | 873.1 | 934.2 | 1,018.3 | 1,099.8 | 1,187.8 |
| Sukuk supply-demand gap | 126.2 | 156.9 | 165.5 | 128.6 | 81.4 | 69.1 | 73.8 | 78.9 | 81.8 | 101.4 |

Source: Refinitiv sukuk supply and demand model

### Sukuk supply and demand equilibrium 2018 to 2027F




Source: Refinitiv sukuk supply and demand model

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